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**THE IMPACT OF GRAMM-RUDMAN-HOLLINGS REDUCTIONS ON THE
SUPERVISORY AND REGULATORY ROLES OF THE FEDERAL
DEPOSIT INSURANCE CORPORATION, THE FEDERAL HOME
LOAN BANK BOARD, THE OFFICE OF THE COMPTROLLER OF
THE CURRENCY, AND THE NATIONAL CREDIT UNION ADMINIS-
TRATION**

HEARING
BEFORE THE
SUBCOMMITTEE ON
GENERAL OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-NINTH CONGRESS
SECOND SESSION

—
JUNE 17, 1986
—

Serial No. 99-90

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Printed for the use of the
Committee on Banking, Finance and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

62-257 O

WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
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THE IMPACT OF GRAMM-RUDMAN-HOLLINGS REDUCTIONS ON THE SUPERVISORY AND REGULATORY ROLES OF THE FEDERAL DE- POSIT INSURANCE CORPORATION, THE FED- ERAL HOME LOAN BANK BOARD, THE OFFICE OF THE COMPTROLLER OF THE CURRENCY, AND THE NATIONAL CREDIT UNION ADMINIS- TRATION

TUESDAY, JUNE 17, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS,
Washington, DC.

The subcommittee met at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Carroll Hubbard, Jr. (chairman of the subcommittee) presiding.

Present: Chairman Hubbard; Representatives Gonzalez, Kanjorski, Fuster, Parris, Bartlett, and McCandless.

Chairman HUBBARD. The Subcommittee on General Oversight and Investigations of the House Banking, Finance and Urban Affairs Committee will now come to order.

On behalf of all the members of our subcommittee, some of whom are here now and others who will join us, I want to take this opportunity to welcome you here today. We indeed welcome each of our witnesses. We welcome each of our guests who have come to the Washington area, and permit me to say how delighted I am to have a group of outstanding young ladies from Kentucky, my home State, including some from my own district, who are here for a convention with the League of Women Voters. They are in attendance, about eight of them, at our hearing this morning. We are glad they are here.

Our hearing this morning is geared to a very specific purpose. We have invited officials of the financial institutions regulatory agencies to discuss how imposition of the provisions of the Gramm-Rudman-Hollings legislation and the apportionment provisions of the Anti-Deficiency Act will affect the operations and capabilities of their respective agencies.

As we are all aware, Gramm-Rudman-Hollings threatens to greatly constrict a wide spectrum of Federal Government activities and programs. Indeed, fiscal year 1986 has already seen round one of the cuts phased into operation.

While a deficit reduction process in some form is of utmost importance to our future—and I underline that—the merits of Gramm-Rudman-Hollings are not at issue here today.

Gramm-Rudman-Hollings is in the headlines almost every day, including yesterday and today due to inaction, as predicted by ABC, by the Supreme Court yesterday on the constitutionality of Gramm-Rudman-Hollings.

But today we want to focus upon the determinations of the Office of Management and Budget that Gramm-Rudman-Hollings and the Anti-Deficiency Act apply to the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency, and the National Credit Union Administration, and how the application of their provisions will affect these agencies' abilities to supervise and regulate their member institutions.

This has developed into a highly controversial issue largely because these agencies receive no appropriations of Federal dollars and because reductions in their expenditures would have little meaningful effect on Federal expenditure levels and no real effect on deficit reduction efforts.

Hence, the Office of Management and Budget's determinations are of great concern to many legislators here on Capitol Hill, both on the Senate side and the House side.

Almost on a daily basis, major newspapers across the Nation report of the plight of many of our financial institutions. The decade of the 1980's has not been very kind thus far, and most predict that we can expect record failures of banks and savings and loan associations this year due to continuing problems in agriculture and real estate, and as a result of the sudden depression of the oil industry.

Not only are the numbers of failures expected to increase, the numbers of institutions on the problem lists are expected to greatly increase as well.

One of our witnesses, Bill Seidman, has spoken recently about the problems of banks across the United States and about how many may fail during this year of 1986.

Such would suggest that increased supervisory efforts should be in order, and it is not difficult to comprehend the justification for concern about whether the regulatory agencies will operate effectively under the OMB mandate.

Another of the agencies' concerns involves apprehension that the Office of Management and Budget's actions may impede their functional independence. Indeed, the ability to operate free from the political pressures of the budgetary and appropriations process has always been a strong factor in these agencies' capacities to respond flexibly to changing conditions which might have bearing on the safety and soundness of their member institutions.

As chairman of this subcommittee, I am sure our witnesses are pleased that legislation has been introduced in the House which would exempt their agencies from Gramm-Rudman-Hollings and the Anti-Deficiency Act.

Yes, H.R. 4917, the Depository Institution Examination Improvement Act of 1986, was coauthored by our colleagues on the House Banking Committee, Congressmen Tom Carper and Stan Lundine,

and this legislation is pending before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance where a markup is expected soon.

I encourage our witnesses today to comment on the relevant portions of that bill, as introduced by Congressmen Lundine and Carper, H.R. 4917.

I want to again emphasize that we are certainly aware of the importance of deficit reduction efforts, but we must also be cognizant of the need for sound judgment and logic in seeing that these efforts are not misdirected.

In that spirit, we are anxious to hear the testimony of our witnesses today and to learn of the problems facing their agencies as a result of the actions of the Office of Management and Budget.

In carrying out our oversight duties within this subcommittee, we strongly emphasize our concern for the safety and soundness of our Nation's financial system, and we stress the importance of minimizing the risk of exposure of the Federal deposit insurance and Federal savings and loan insurance funds.

We look forward to receiving the testimony from our distinguished panel, which includes Hon. L. William Seidman, Chairman of the Federal Deposit Insurance Corporation, Hon. Edwin J. Gray, Chairman of the Federal Home Loan Bank Board, and Hon. Robert L. Clarke, the Comptroller of the Currency.

Indeed, these are heavy hitters for our subcommittee to have before us today, and we appreciate the three of them being here.

First, I would like to call on other Members of the subcommittee for any opening statements that they would like to make.

[Under unanimous-consent agreement the opening statement of Congressman Stan Parris follows:]

OPENING STATEMENT OF HON. STAN PARRIS

Mr. Chairman, today's hearing on the impact of the Gramm-Rudman-Hollings Act on the agencies that regulate our Nation's financial institutions could be a significant one. I welcome and thank our distinguished panel for taking the time to testify before us today.

As we all know, the Office of Management and Budget has set its sights on control of the supervisory and administration budgets of the FDIC, the Federal Home Loan Bank Board, the National Credit Union Administration—as well as the entire budget on the Comptroller of the Currency. At a time of unprecedented strains on many of the financial institutions these agencies regulate, the regulators have had to comply with a 4.3-percent cut mandated March 1 by Gramm-Rudman. Thus, while the insurance functions of the FDIC and FSLIC are exempt from the Gramm-Rudman law, the means by which these agencies carry out their mandate is unwittingly subject to the new law's budget-cutting provisions. The result: efforts to hire and train more examiners and implement better supervisory programs to keep up with a wave of failures and assistance transactions have been squeezed by the automatic reductions of Gramm-Rudman.

Of course, the Supreme Court may soon blunt the harmful impact of another sequestration order, which the new law provides if Congress is unable to meet the fiscal year 1987 budget deficit target of \$144 billion.

Nevertheless, as you know, OMB, buoyed by its success in extending the Gramm-Rudman budget cuts of the regulators, has now attempted to subject the FDIC's budget to the Anti-Deficiency Act, which would give the Budget Office power over the timing of FDIC expenditures. This could eliminate the fund's flexibility to respond to failures, especially if assistance in any one-quarter is particularly heavy. An adaptation of Senator William Fulbright's famous description of Congress seems appropriate to FDIC's situation: "CMB has the power to do any damn fool thing it wants to do, and it seems to do it about every 10 minutes."

To most of our constituents, these issues appear to involve the use of arcane laws in a bureaucratic turf battle. Unfortunately, the stakes could run higher if the regulators of our financial institutions are hampered in their efforts to deal with a staggering number of federally insured institutions that are experiencing financial difficulty.

Gentlemen, as you know, we are sympathetic to your plight and anxious to assist in devising a legislative solution, as are many other members of the Banking Committee. Neither of us supported the meat-ax approach to deficit reduction offered by Gramm-Rudman. We know all too well about the management troubles Chairman Gray has experienced at the Home Loan Bank Board due to OMB restrictions. As you know, we are both cosponsors of the Depository Institution Examination Improvement Act, a bill which would remedy many of your concerns about the detrimental budget and appropriation review procedures to which you are subject, offered by our colleague from Delaware, Mr. Carper.

I for one find compelling the argument that your agencies should be exempt from Gramm-Rudman because your operations are funded by assessments on the industry you regulate—not the taxpayers. And I agree with you that an exemption is warranted when not \$1 of budget savings you achieve will have any effect on the Federal deficit.

Finally, a word of counsel to the Chairman of the FDIC, for what it is worth. I wish you well in your dealing with OMB. Many of us support your position, Bill. But remember, when a person with experience meets a person with money, the person with the experience will get the money and the person with the money will get the experience.

Thank you, Mr. Chairman. I look forward to hearing the witness' testimony this morning.

Chairman HUBBARD. I now call on first my colleague, Congressman Henry Gonzalez of San Antonio, TX.

Mr. GONZALEZ. I really thank the chairman because I may have to leave. I have a visiting group of local officials that are here to see about what they are facing on account of "damn Rudman," as one poor public housing tenant said here in this same committee room a few weeks ago.

I voted against it. So my conscience is clear there.

And also, I think it is significant that the reason these local officials are here is that we had a very serious train derailment, causing better than 2,000 persons to be evacuated. This time it happened in an affluent section of town, so there is a lot of notice. When it happened in the poor sections, nobody seemed to care.

But Gramm-Rudman will mandate a reduction in the meagre corps of railroad safety inspectors that the whole Nation has. It has less than 275 for the whole country. Gramm-Rudman would mandate a further cut.

If San Antonio were to have a second diphtheria epidemic that it had about 15 years ago, the Atlanta Center for Disease Control wouldn't have enough serum to provide the city because of Gramm-Rudman.

So that in this case I know it is very vital that we have the testimony, but I wanted to advise the chairman that if I leave it is only because I have this waiting delegation of local officials on some pending legislation and also what we can do to reduce the impact of Gramm-Rudman in that case.

I want to congratulate the three witnesses. I want to also again reiterate my admiration for the fine work that Chairman Gray is doing and commiserate with him and say that anything that is done in this line of endeavor certainly has my help.

I want to advise for the record, Mr. Chairman, that I put in a repealer on Gramm-Rudman the day after the President signed it. So I guess that shows you where I stand on this.

If we could take care of that repealer, we wouldn't have to work piecemeal on trying to salvage the wreck.

Anyway, thank you for the opportunity, Mr. Chairman.

Chairman HUBBARD. Thank you, Chairman Gonzalez. There were only two of us who voted "no" on Gramm-Rudman, and I was one of the two, but I confess I didn't introduce repealer legislation the next day after the President signed it.

I would next like to call on Congressman Paul Kanjorski, of the State of Pennsylvania, for an opening remark.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

I look forward to the hearing today both in respect to what we may learn from these independent agency heads and what we may learn from the handing down of the decision from the Supreme Court on this issue. As a result we may have some rules set up or some situation set up which may test the validity of the independent agencies that we have established over the years.

As a Member of Congress who had the distinct pleasure with only one other Member of Congress of twice voting against "damn Rudman," I think today may be our day of vindication.

I look forward to the administration officials shedding some light on the subject after the passage of the act and intend to inquire into why we didn't get their expert advice prior to the enactment of the act.

Thank you, Mr. Chairman.

Chairman HUBBARD. Thank you, and next we call on our colleague and friend from beautiful Puerto Rico, the Honorable Jaime Fuster.

Mr. FUSTER. Thank you, Mr. Chairman.

I don't have an opening statement, but I do want to commend the chairman for calling these hearings. I share his grave concern about the impact that Gramm-Rudman may have on the financial institutions' regulatory agencies and the impact in the long run on the safety and soundness of the Nation's financial system.

So I believe that these hearings are very proper and necessary, and as I said, I want to commend the chairman, and I am very happy to participate in them.

Chairman HUBBARD. Thank you very much, and we next call on our friend and colleague from California, the Honorable Congressman Al McCandless.

Mr. McCANDLESS. Thank you, Mr. Chairman.

I do not have an opening statement. However, I must respectfully disagree with my colleagues on Gramm-Rudman. Without something of this nature, the financial chaos that would result in our continued spending, not only at the national but the international level, would make some of the stories that I have just heard sound like a kindergarten primer.

I am looking forward to Mr. Seidman, Mr. Gray, and Mr. Clarke's testimony, and I think we should move on.

Chairman HUBBARD. Thank you.

But before we proceed, allow me to insert the June 16, 1986 letter from the Honorable Roger W. Jepsen, former U.S. Senator

and now Chairman of the National Credit Union Administration who, unfortunately, was unable to be here with us but has submitted a statement for the record. He asks that it be entered in the record.

Is there objection?

[No response.]

Chairman HUBBARD. Without objection, his letter and statement will be entered in the record at this point.

He explained in the June 16 letter that a longstanding commitment precluded his attendance at our hearing today on the effect of Gramm-Rudman-Hollings on the financial institutions' regulators.

[The letter and statement referred to of Chairman Roger W. Jepsen, National Credit Union Administration follow:]



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20438

June 16, 1988

Honorable Carroll Hubbard Jr.
Chairman
Subcommittee on General Oversight
and Investigations
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515-6852

Dear Mr. Chairman:

I regret that a longstanding commitment precludes my attendance at your hearing tomorrow on the effect of Gramm-Rudman-Hollings on the financial institution regulators.

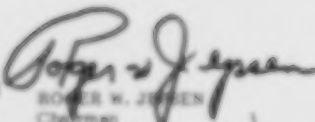
Attached is my statement for the record. I do want to emphasize that the National Credit Union Administration receives no tax money for any of its activities and has no real impact on the national deficit. Therefore, it is illogical and unreasonable for Gramm-Rudman-Hollings to apply to NCUA.

At this time of rapid growth, economic change, and substantial deregulation, we need more, not less, supervision and quality examination of credit unions.

Thank you for your concern for this most important issue.

With kindest personal regards, I am

Sincerely,


ROGER W. JENSEN
Chairman

RW:jms

STATEMENT OF
ROGER W. JEPSEN
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION
FOR
SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON BANKING, FINANCE
AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

JUNE 17, 1986

Mr. Chairman, thank you for allowing the National Credit Union Administration the opportunity to submit this statement on the effects of the Gramm-Rudman-Hollings Act on our Agency. We are greatly concerned by the potential adverse impact of this statute not only on NCUA, but more importantly, on the safety and soundness of our Nation's credit unions.

The National Credit Union Administration charters, supervises and insures 10,000 Federal credit unions. At yearend 1985, these credit unions had combined assets of \$78 billion, shares totaling \$72 billion, loans of \$48 billion, and nearly 30 million members. In addition, the Agency insures member accounts at another 4,969 state-chartered credit unions, with nearly 16 million members. We receive no appropriation of tax money from the Congress for any of our activities. Rather, NCUA is funded exclusively by credit unions and by earnings on investments.

NCUA's funding is segregated into three separate accounts or funds. These are the Operating Fund, the National Credit Union Share Insurance Fund (NCUSIF), and the Central Liquidity Facility (CLF). All these are U.S. Treasury accounts classified as public enterprise revolving funds.

The Operating Fund is used for the payment of Agency expenses such as payroll, travel, and administrative costs. Revenue is derived from an annual operating fee assessment from all federally-chartered credit unions and from expense reimbursements from the Share Insurance Fund and the Central Liquidity Facility. The operating fee assessment is approved each year by the NCUA Board in an amount sufficient to cover budgeted expenses.

The Share Insurance fund pays liquidation costs and financial costs (such as the expenses associated with mergers) directly and reimburses the Operating Fund for its share of the Agency's operating expenses. Revenue is currently derived entirely from the interest earned on credit union-contributed capitalization deposits. The NCUA Board also has the authority to assess an insurance premium on insured credit unions to finance expenses of the Fund. However, since the Fund was capitalized by Act of Congress in 1984, we have not had need for a premium assessment.

The CLF is supported by earnings on investments and interest on loans to credit unions. The capital used for investments is derived from credit union stock subscriptions. Member credit unions are required to maintain one quarter of one percent of their paid-in and unimpaired capital and surplus in CLF capital stock. Another one quarter of one percent of paid-in and unimpaired capital and surplus must be held by the member in liquid assets on call by the CLF. The CLF does appear before Congress annually for limitations on borrowing and expenditures, but not for appropriations.

Once again, Mr. Chairman, none of these accounts receives tax revenues from the Treasury.

In recent years we have seen an acceleration in the growth of all aspects of the credit union movement. Members of federally-insured credit unions are up from 37 million in 1980 to over 46 million today; assets at Federal credit unions have grown from \$30 to an estimated \$82 billion in March of this year. This dramatic growth has been accompanied by a greatly increased sophistication among both credit union members and officers. Many credit unions now offer a full range of consumer financial services to their members. Another significant factor increasing NCUA's workload is the large number of conversions from private to Federal insurance which have occurred over the past year and are continuing.

In today's environment of substantial deregulation, there is a great need for a quality, experienced examiner force to safeguard the savings of credit union members and the assets of the National Credit Union Share Insurance Fund. At NCUA we believe less regulation in Washington ought to be accompanied by more supervision in the field. However, given the present constraints on hiring and promoting our examiner force, it is increasingly difficult for NCUA to fulfill its statutory mission of promoting and protecting credit union safety and soundness.

In 1965, Mr. Chairman, the Agency had approximately 300 examiners. Today we have 347 - a 16% increase. During this same period of time we have seen a 1,686 percent increase in the size of the average Federal credit union, from \$431,000 to \$7.7 million. In 1965, only one Federal credit union had more than \$50 million in assets. Now 482 federally-insured credit unions exceed this level with the largest exceeding \$2 billion in assets.

NCUA's field examiner turnover rate for the four-year period from 1982 through 1985 averaged 16.5% annually. During this period, out of an average field examiner work force of 357 positions, including supervisory examiners, there were a total of 236 separations, or 59 annually, from the Agency. This condition creates a number of adverse results, including the devotion of a disproportionate amount of the Agency's human and financial resources to the hiring and training of new, unskilled examiners.

Our most experienced examiners often leave the Agency for much more lucrative positions in the private sector. In fact, because of inadequate salary levels, NCUA typically devotes substantial funds and other resources to developing a skilled, experienced examiner only to find that our Agency has served as a training ground for credit unions and others.

Gramm-Rudman-Hollings, of course, would greatly compound this already serious problem. Legally, it seems that NCUA is generally included within the statute's purview, except that the National Credit Union Share Insurance Fund is exempt with respect to "prior legal obligations." Therefore, despite the obvious need for more, not less, examiners, Gramm-Rudman-Hollings, could actually compel NCUA to cut back on its examination force and program.

We have been working closely with both OMB and OPM on our personnel concerns and we are encouraged by the helpful and cooperative spirit we have found at those Agencies. However, Gramm-Rudman-Hollings cannot be changed administratively. The Congress must act to amend the statute.

In the present year, fiscal '86, the 4.3% cut mandated by Gramm-Rudman-Hollings translated into a \$1.4 million reduction at NCUA. However, due to the fact that we are just now approaching full use of our budget, its impact has been minimal.

Next year, when we will be fully staffed to our budget allocation, the impact on NCUA could be severely damaging to our mission of ensuring safety and soundness for credit unions. Approximately 70% of our budget is devoted to payroll and 10% to travel, mostly by examiners. The remainder of the budget is for non-discretionary administrative expenses such as rent, communications, and utilities. Credit union examiners and examiner-support positions account for over 80% of our staffing. As a result, any significant reductions, such as a potential Gramm-Rudman-Hollings' sequestration of 15%, will have an immediate adverse effect on our ability to examine credit unions.

The only alternative available for NCUA to achieve a reduction of that magnitude would be through furloughs. Our actual experience in recent years has been that very little net savings can be achieved through reduction-in-force procedures. We have estimated that if a 15%

reduction in the FY87 budget was accomplished through furloughs, approximately 35 % of Federal credit unions would not be examined in FY87. In addition, our current initiatives to improve the quality of our examination program, principally through greatly increased training and educational programs, would have to be completely abandoned.

All federally-chartered credit unions are currently examined annually, a vital element in our efforts to maintain safety and soundness. Large scale employee furloughs would necessarily result in an immediate severe lengthening of the examination cycle.

Our experience with lengthening the examination cycle beyond one year has shown that the entire examination system soon begins to deteriorate.

For the period from 1977 through 1982, the examination cycle averaged as high as 24 months, and some Federal credit unions were not examined for 36 months or longer. While the economic recession during this period severely impacted credit unions, the longer examination cycle clearly contributed to the dramatic increase in insurance losses. We found that in many cases when an examiner returned to a credit union after 24 to 36 months the situation was terminal and many credit unions were liquidated or merged. Also, as a result of the longer examination cycle, credit union problems generally became more critical, and the number of classified problem-case credit unions peaked at 1,192 in 1982.

Mr. Chairman, at this point I will explain the particular adverse effect that sequestration could have upon the Central Liquidity Facility.

In order to carry out its lending program, the CLF utilizes the corporate credit union distribution system, and operates with a staff of only six permanent employees. Through the corporate credit union system, 43 corporate credit unions (with an average staff of 15 each) act

as agents on behalf of the CLF, making the CLF available to 97 percent of the nation's credit unions. In return for their services, the 43 corporate credit unions are paid an agent reimbursement fee. In fiscal year 1985, approximately 50 % of the CLF's operating expenses were agent reimbursements, with the other 50 % paying for the 6 permanent positions and administrative expenses. This year, the agent reimbursement percentage has been approximately 55 percent.

Any significant reduction of the CLF's operating budget would render the CLF inoperable. The CLF does not have the authority or ability to reduce the agent reimbursements it pays. The corporate credit unions would not act as agents or provide services on behalf of the CLF without the current reimbursement program. The only alternative for the CLF would be to establish its own distribution system, requiring at least several hundred employees. Finally, the current permanent staff of 6 is considered the minimum number required to manage and administer the CLF's operations. In short, any reduction of the CLF's operating budget would threaten the financial stability of the credit union system.

Mr. Chairman, under Gramm-Rudman-Hollings sequestration the CLF might be destroyed and the examination program would become a defensive process, with greater and greater amounts of effort devoted to dealing with a growing number of problem cases.

In conclusion, the laudable purpose of the Gramm-Rudman-Hollings Act is to reduce our national deficit. Reducing NCUA's expenditures will not reduce the national deficit. Therefore, it is illogical and unreasonable for the Gramm-Rudman-Hollings Act to apply to the National Credit Union Administration.

Thank you for the opportunity to present NCUA's views on this important issue.

Chairman HUBBARD. We now call on the Honorable L. William Seidman, Chairman of the Federal Deposit Insurance Corporation, for his statement.

**STATEMENT OF HON. L. WILLIAM SEIDMAN, CHAIRMAN,
FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)**

Mr. SEIDMAN. Thank you, Mr. Chairman, members of the subcommittee. We appreciate the opportunity to be here and address this important issue of Gramm-Rudman-Hollings and the Anti-Deficiency Act and its effect on the FDIC.

We are greatly concerned about the adverse effects of the imposition of Gramm-Rudman-Hollings on the FDIC operations. These reductions could hamper effective bank supervision and thereby result in increased exposure of the deposit insurance fund.

Last year, 120 banks failed or needed assistance, and we expect 140 to 160 more to fail or need assistance this year. The number of banks on the FDIC's problem list currently stands at well over 1,300 and continues to grow. Our need for flexibility and adequate resources, particularly in our supervisory and enforcement programs, is greater now than ever before in our history.

Before discussing Gramm-Rudman, let me briefly address the sources of FDIC funding. The FDIC receives no appropriation from Congress. Insurance assessments from insured banks and investment income are and always have been the agency's exclusive source of funds.

Given the nature of the FDIC's funding, any reduction in our expenditures will have no real effect on Federal expenditure levels. Such expense reductions will, however, undercut our supervisory efforts and thus contribute to an increased incidence of bank failures. More failures means our total costs will increase, not decrease.

The Office of Management and Budget and the General Accounting Office have concluded that Gramm-Rudman-Hollings applies to the administrative expenses of the FDIC. They reached that conclusion despite the fact that the statutory language and legislative history supports excluding the FDIC from Gramm-Rudman-Hollings.

Senator Packwood, chairman of the Senate Finance Committee and head of the Gramm-Rudman-Hollings Senate conferees, stated: "We also exempted numerous other programs in which there was no argument, such as the Federal Deposit Insurance Corporation Act."

The activities that OMB considers to be subject to this sequestration include the cost of supervision as an administrative expense. Supervisory costs alone amount to over two-thirds of the total expenses OMB classifies as administrative and therefore subject to reduction.

The language of Gramm-Rudman-Hollings belies OMB's interpretation of what constitutes sequestrable expenses. The statute lists the FDIC among those entities whose legal obligations are exempt from the sequester orders.

The FDIC's legal obligation is to provide deposit insurance and operate the deposit insurance system. This includes liquidating

failed banks' assets, handling failing and troubled banks, and supervising banks to protect the insurance fund.

In our view, OMB should not be able to sequester supervision activities as administrative expenses, but of course they have done so.

In keeping with the spirit of Gramm-Rudman-Hollings—and we approve of that spirit—we have voluntarily reduced our expenditures by the required 4.3 percent or \$8.5 million for the current year. This required making cutbacks in a number of important areas.

We have curtailed hiring and training of personnel, reduced travel, postponed building improvements, and deferred a number of important projects. These projects included developing better management information systems and other computer programs that would facilitate bank supervisory activities and other insurance-related functions.

We are most concerned about the potential impact of Gramm-Rudman-Hollings on our supervisory capabilities, including the examination and oversight of troubled and failing banks.

Let me explain where our supervisory program stands now.

The FDIC has a force of 1,670 field examiners. These are the individuals who go out to examine banks, and they account for 85 percent of the professional staff of our Division of Bank Supervision. The size of the field force is almost exactly where it was 5 years ago, but a lot has happened since then.

In 1981, commercial banks earned a return on assets of 81 basis points, 27 percent more than the 64 basis points earned in 1985. Three times more banks lost money in 1985 than in 1981.

As I said, today we have over 1,300 problem banks, six times as many as we had in 1981. In 1981, 10 banks failed. We average more than that number every month in the current year.

This increase in problem and failing banks has put a major strain on our field examiners, a force which, because of self-imposed restrictions, was allowed to shrink in recent years. Our field force was down to only 1389 by the end of 1984. Moreover, during the last 3 years we had to detail 10 to 15 percent of our examiners to assist with the greatly increased number of failed bank liquidations.

The combination of increasing work demands and a shrinking workforce caused major cutbacks in examinations. We have relied much more on brief visitations, which are much less comprehensive than exams. A number of specialty examinations—consumer compliance, trust departments, data processing facilities—were all cut back as well.

Still, we continued to fall behind while the banking problems grew.

No longer were we able to meet our minimum policy guidelines which call for examination of marginal and problem banks at least once a year with a visitation in between.

In some of our regions, we are averaging 20 months between exams. As for satisfactory banks, our visitation period was extended to 3 years. We were not always able to do even that, and we are not comfortable with the 3-year interval.

Experience has shown that examinations 2 to 3 years old quickly lose their value.

Beginning in 1985, the FDIC started to rebuild its examination force. Our target is to reach 1,800 examiners by the end of this year.

Since our field examiner turnover rate has been running about 11 to 12 percent, we had to hire about 450 examiners over the last year to get where we are now.

Currently, about one-third of our field force has less than 1½ years experience. This imbalance impacts our productivity. Training these people, most of which is done on the job, takes a substantial amount of time away from our seasoned examiners, time needed to examine. It takes longer to complete examinations, particularly in marginal and problem institutions, where we have had to use many of these young people.

In 1985, the examination of such banks averaged 24 percent longer than in 1984.

In today's increasingly competitive deregulated environment, strong safety and soundness supervision is needed more than ever. We continue to evaluate our total examiner needs, but preliminary figures indicate that we will need more than 2,000 field examiners by the end of 1987.

This would allow us to meet our goal of shortening the intervals for examining banks. It would also allow us to increase our involvement in the examination of all problem banks we insure.

Finally, we would be able to resume a more reasonable schedule for conducting specialized examinations in consumer compliance, trust departments and data processing.

The cutbacks anticipated under Gramm-Rudman for 1987 and beyond would undo any progress we have made this far in rebuilding our examination force.

As we have done this year, we would attempt to minimize the impact on our field force, but assuming Gramm-Rudman cuts in the order of 10 to 20 percent, major examination reductions would be unavoidable.

For every hundred examiner reduction, we would lose the capability to conduct 225 examinations a year. We estimate that the examination cutback in the order of 15 percent would be over 600 of the 4,000 safety and soundness exams budgeted for the year.

Stretching out examination intervals any further in this banking environment would be counterproductive. The reduction in bank examination activity will diminish our ability to detect unsound banking practices and fraud and take timely corrective action.

The net effect of these savings will be higher insurance costs and less stability in the financial system.

Vital automated services supporting bank supervision also would suffer as well; even extremely modest cuts, in the order of 10 percent, would indefinitely delay integrating bank performance data sources into our offsite surveillance system.

Let me now turn and address the Anti-Deficiency Act. On several previous occasions, OMB has attempted to assert control over the FDIC budget. It has always and repeatedly been rebuffed by the Congress.

Now, OMB is raising for the first time the novel claim that a 36-year old statute, the 1950 Anti-Deficiency Act, authorizes it to appropriate and set the size of our budget.

With this authority, they intend to deal with the substantive issues facing the FDIC. We are convinced that their claim is without legal merit, and we have filed with you a brief in that regard.

Nevertheless, if OMB is allowed to go forward, the FDIC Board and the Congress will lose control of our budget. Control of the budget will inevitably permit the policy control OMB seeks.

The application of the Anti-Deficiency Act would change the historic position of the FDIC as a bipartisan, independent agency. It would do so not by any current of expression of congressional will, but by applying this 36-year old statute, which OMB asserts gives it the powers that Congress has repeatedly denied to the agency in the past.

The unfortunate experience of the Federal Home Loan Bank Board, when OMB was controlling its supervisory budget—and Chairman Gray can certainly talk to this subject—indicates the loss of budget control by the FDIC could lead to even more serious problems than created by Gramm-Rudman.

In fact, the Bank Board had to put its supervision beyond the reach of OMB by placing its examiners in the regional Federal Home Loan Banks. Unfortunately, this alternative is not available to the FDIC.

OMB has already indicated that they budget a 1991 surplus for our agency of \$3.1 billion, an amount, incidentally, which equals our total revenues without any expenses during the current year.

Congress has, on several occasions, reviewed the FDIC's budgetary process and has always concluded that our budget should remain outside the executive branch in the appropriations process.

Congress has concluded that the FDIC's functional independence is tied to its budgetary independence. We recognize that such independence carries with it responsibility to meet the highest standards of accountability in financial reporting.

Congressional oversight can assure that the legitimate objectives of disclosure and accountability can be achieved within a framework of independent budgetary treat.

In these days of unusual stress in the financial systems of the country, fundamental changes should be attempted only if a major problem with the present system can be identified. No such problem has been found.

The risk of such a change in regulatory operations simply is not justified, but only the Congress can act to assure that none will be mandated.

That concludes my remarks, Mr. Chairman.

[The prepared statement of Chairman Seidman with attachments, follow:]

STATEMENT ON THE EFFECTS OF THE
DEFICIT REDUCTION ACT OF 1985
(GRAMM-RUDMAN-HOLLINGS ACT)
ON
THE FEDERAL DEPOSIT INSURANCE CORPORATION

PRESENTED TO
SUBCOMMITTEE ON GENERAL OVERSIGHT
AND INVESTIGATIONS
COMMITTEE ON BANKING, FINANCE
AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

Room 2128, Rayburn House Office Building
June 17, 1986
10:00 a.m.

I. INTRODUCTION

Mr. Chairman, I appreciate the opportunity to be here today to testify on the impact of the Gramm-Rudman- Hollings Act ("GRH") and the Antideficiency Act upon the FDIC.

We are greatly concerned about the adverse effects the imposition of GRH would have on FDIC operations. If applicable, GRH would impose major budget cuts upon our agency. Those reductions would hamper effective bank supervision and thereby result in increased exposure of the deposit insurance fund.

Last year, 120 banks failed or needed FDIC assistance, and we expect 140 to 160 more this year. The number of banks on the FDIC's problem list currently stands at more than 1,300 and continues to grow. Our need for flexibility and adequate resources, particularly in our supervisory and enforcement programs, is greater now than ever before.

First, I will address the sources of FDIC funding. After discussing GRH, I will comment briefly on the proposed applicability to the FDIC of the Antideficiency Act's apportionment provisions. Like GRH, the Antideficiency Act poses a real threat to the FDIC's ability to carry out its mission.

II. DISCUSSIONA. FDIC's Funding

The FDIC receives no appropriations from Congress. Insurance assessments from insured banks and investment income are, and always have been, the agency's exclusive sources of funds. The Federal Deposit Insurance Act ("FDI Act") authorizes an annual assessment on insured banks of one-twelfth of one percent of a bank's assessable deposits. It also provides that, with certain exceptions, the FDIC must annually rebate 60 percent of its net assessment income (assessment income less operating and insurance expenses and insurance losses) to those insured banks. The remaining forty percent of net assessment income, plus the investment income earned by the FDIC, is added to the FDIC trust fund, which is available to meet the insurance obligations of the FDIC. The FDIC is required by section 13(a) of the FDI Act to invest its funds in United States securities or obligations guaranteed by the United States Government.

Given the nature of the FDIC's funding, any reduction in our expenditures will have no real effect on federal expenditure levels, though for reporting purposes the additions to our reserve for insurance losses will be treated as a reduction of the deficit.⁴ Such expense reductions will,

⁴ The fact that OMB uses the annual change in the FDIC's unobligated balances (cash flows) as a line item to reduce the overall deficit is an accounting artifact that has no practical significance. As a matter of law, FDIC funds are not available for use by other government agencies.

however, undercut our supervisory efforts and thus contribute to an increased incidence of bank failures.⁴⁰ More failures mean our total costs will increase, not decrease.

B. FDIC's Statutory Exemption from GRH

Despite the compelling legal and policy reasons for exempting the FDIC from GRH, the Office of Management and Budget ("OMB") and the General Accounting Office have concluded that GRH is applicable to "administrative expenses" of the FDIC. OMB reached that conclusion despite the fact that the statutory language and legislative history clearly support excluding the FDIC from GRH. Senator Packwood, Chairman of the Senate Finance Committee and head of the GRH Senate conferees, stated that "[w]e also exempted numerous other programs on which there was no argument, such as the Federal Deposit Insurance Corporation."⁴¹

The activities that OMB considers to be subject to sequestration include classifying supervisory expenditures as administrative expenses subject to reduction. Supervisory costs alone, without these support activities, amount to over two-thirds of the total expenses OMB deems "sequestrable" as administrative.

⁴⁰ In addition to undermining safety and soundness examinations, supervisory cutbacks would hinder our ability to determine compliance with consumer laws, including the Truth-in-Lending Act, the Fair Credit Reporting Act, the Fair Housing Act, the Community Reinvestment Act, the Home Mortgage Disclosure Act, the Fair Debt Collection Practices Act, the Electronic Funds Transfer Act, and the Equal Credit Opportunity Act.

⁴¹ 131 Cong. Rec. S. 14782 (Dec. 11, 1985).

The language of GRH belies OMB's interpretation of what constitutes "sequestrable" expenses. That statute lists the FDIC among those entities whose "legal obligations" are exempt from sequester orders. The FDIC's "legal obligation" is to provide deposit insurance and operate the deposit insurance system, including liquidating failed banks' assets, handling failing and troubled banks, and supervising banks to protect the insurance fund. Accordingly, OMB should not be able to sequester these activities as "administrative expenses."

Impact of GRH on the FDIC

In keeping with the spirit of GRH, we have voluntarily reduced our expenditures by 4.3 percent or \$8.5 million. As shown on Table I, this required making cutbacks in a number of important areas. We curtailed hiring and training of personnel, reduced travel, postponed building improvements, and deferred a number of important projects. These projects included developing better management information systems and other computer programs that would facilitate bank supervisory activities and other insurance-related functions.

We are most concerned about the potential impact of GRH on our supervisory capabilities including the examination and oversight of troubled and failing banks. To appreciate the extent of our concerns, let me explain where our supervisory program stands now.

The FDIC has a force of about 1,670 field examiners. These are the individuals who actually go out to examine banks, and they account for 85% of

the professional staff of our Division of Bank Supervision. The size of the field force is almost exactly where it was five years ago, but a lot has happened since then. In 1981, commercial banks earned a return on assets of 81 basis points, 27 percent more than the 64 basis points earned in 1985. Three times more banks lost money in 1985 than in 1981. Today we have about 1,300 problem banks -- six times what we had back then. In 1981, ten banks failed; we average more than that in a month now.

This increase in problem and failing banks has put a major strain on our field examiners, a force which, because of self-imposed restrictions, was allowed to shrink in recent years. As Table II shows, our field force was down to only 1389 by the end of 1984. Moreover, during the last three years, we have had to detail 10 to 15 percent of our examiners to assist in the liquidation of failed banks.

The combination of increasing work demands and a shrinking work force caused major cutbacks in examinations. We have relied much more on brief visitations, which are much less comprehensive than exams. A number of specialty examinations (consumer compliance, trust departments, and data processing facilities) were cut back as well (see Table II). Still, we continued to fall behind while the banking problems grew. No longer were we able to meet our minimum policy guidelines, which call for examinations of marginal and problem banks (CAMEL ratings 3, 4, and 5) at least once a year with visitations in between. In some of our regions, we're averaging 20 months between exams. As for satisfactory banks (CAMEL ratings 1 and 2), our visitation period was extended to three years. We're not always able to do even that, and we are not comfortable with three year intervals. Experience has shown us that examinations two to three years old quickly lose their value.

Beginning in 1985, the FDIC started to rebuild its examination force. Our target is to reach 1,800 examiners by year's end. Since our field examiner turnover rate has been running about 11-12%, we have had to hire about 450 examiners over the last year to get where we are now. Currently, about one-third of our field force has less than one and one-half year's experience. This imbalance impacts our productivity. Training these people, most of which is done on the job, takes a substantial amount of time away from our seasoned examiners -- time needed to examine. It's taking longer to complete examinations, particularly in marginal and problem institutions where we've had to utilize many of these people. In 1985, for example, the examinations of such banks averaged 24% longer than in 1984.

In today's increasingly competitive deregulated environment, strong supervision is needed more than ever. We must continue our efforts to strengthen our examiner force if we are to stay on top of our supervisory problems. We are still evaluating our total examiner needs but preliminary figures indicate we should have over 2,000 field examiners by the end of 1987. This would allow us to meet our goal of shortening the interval for examining banks. It would also allow us to increase our involvement in the examination of all problem banks we insure. Finally, we would be able to resume a more reasonable schedule for conducting examinations specializing in consumer compliance, trust departments, and data processing facilities.

The more drastic cutbacks anticipated under GRH for 1987 and beyond would undo any progress we have made thus far in rebuilding our examiner force. As we have done this year, we would attempt to minimize the impact on our field force; but assuming GRH cuts in the order of 10-20%, major examiner reductions would be unavoidable. For every 100 examiner reduction, we would lose the capability to conduct about 225 examinations a year. We estimate that examiner cutbacks in the order of 15% would eliminate over 600 of the nearly 4,000 safety and soundness examinations budgeted for the year. Longer range goals of upgrading examination efforts would have to be abandoned.

Stretching out examination intervals any further in this banking environment would be counterproductive. A reduction in bank examination activity will diminish our ability to detect unsound banking practices and fraud, and take timely corrective measures. The net effect of these "savings" will be higher insurance costs and less stability in the financial system.

Vital automated services supporting bank supervision also would suffer as well. Even extremely modest cuts in the order of 10% would indefinitely delay integrating bank performance data sources into our offsite surveillance system. This would also prevent the maintenance and upgrading of data bank software relied on by the FDIC, the Comptroller of the Currency, and the Federal Reserve. Such cutbacks would seriously undermine our ability to perform cost-effective off-site monitoring.

III. THE ANTIDEFICIENCY ACT

On several previous occasions OMB has attempted to assert control over our budget, but has been repeatedly rebuffed by Congress. Now OMB is raising for

the first time the novel claim that a 36 year-old law -- the 1950 Antideficiency Act -- authorizes it to apportion our budget. With this authority they intend to deal with substantive issues facing the FDIC. We are convinced that their claim is without legal merit (see our legal opinion, attached). Nevertheless, if OMB is allowed to go forward, the FDIC Board and the Congress would lose control of our budget. Control of the budget will inevitably permit the policy control OMB seeks (see letter from OMB Director Miller to Chairman St Germain of the House Banking Committee, attached). The application of the Antideficiency Act would change the historic position of the FDIC as a bipartisan independent agency, and would do so not by any current expression of congressional will but by applying a 36 year-old statute to give OMB powers the Congress has repeatedly denied to the agency in the past. The unfortunate experience of the Home Loan Bank Board when OMB controlled its supervisory budget indicates that loss of budget control by the FDIC Board could lead to even more serious problems than those created by GRH. In fact, the Bank Board has sought to put its supervision beyond the reach of OMB by placing its examiners in the regional Federal Home Loan Banks in order to achieve an effective supervisory force. This alternative is not available to the FDIC.

Congress has on several occasions reviewed the FDIC's budgetary process and has always concluded that our budget should remain outside Executive Branch review and the appropriations process. Congress has concluded that the FDIC's functional independence is tied to its budgetary independence. We recognize that independence carries with it the responsibility to meet the highest standards of accountability and financial reporting. We acknowledge that the

FDIC is a creature of the Congress and, through the Congress, ultimately accountable to the banking industry and the American public. At the same time, the legitimate objectives of disclosure and accountability can best be achieved within a framework of independent budgetary treatment.

Experience with thrifts in states such as Ohio and Maryland -- and with OMB's control over the Federal Home Loan Bank Board's budget -- clearly demonstrates that the lack of adequate supervision can lead to massive failures with excessive costs to all concerned. We cannot project for you what the costs of inadequate bank supervision would be. But you have seen from past experience what can occur. Past problems are dwarfed by the size of the problems we might face if our supervisory functions were to lose flexibility and the ability to act speedily. Imposing new OMB budget controls on the FDIC constitutes a false economy that the nation can ill afford. In these days of great strains in the financial system of the country, fundamental changes should be attempted only if a major problem can be identified, and none has been. The risk of such a change in regulatory operations simply is not justified, and we believe the Congress should act to insure that none is mandated.

Mr. Chairman, that concludes my prepared remarks. I would be pleased to answer any questions you may have.

Attachment

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TABLE I
GRAMM-RUDMAN-HOLLINGS REDUCTIONS
(Dollars in Thousands)

By Expense Category	Reduction in Expense	Percent of Reduction
Salaries	\$ 1,100*	13%
Outside Services	860	10
Travel	3,085	36
Building/Leased Space	2,565	30
Equipment	555	7
Supplies	160	2
Other Expenses (Postage)	200	2
Total	<u>\$ 8,525</u>	<u>100</u> %

*Reduction in DBS only.

TABLE II
Field Examiner Force
and Supervisory Examination Activity
1981 to Present

	<u>Number of Examinations</u>	<u>Number of Visitations</u>	<u>Specialty Examinations</u>	<u>Field Examiner Force</u>	<u>Number of Problem Banks</u>
1981	6,383	1,106	11,909	1,655	223
1982	5,625	1,605	9,501	1,544	369
1983	4,352	2,516	5,895	1,481	642
1984	3,339	2,677	3,723	1,389	848
1985	2,940	2,891	2,673	1,547	1,140
1986*				1,670	1,306

*As of 5/31/86

APPLICABILITY OF THE ANTIDEFICIENCY ACT OF 1950
TO THE FEDERAL DEPOSIT INSURANCE CORPORATION

This memorandum discusses the applicability of the apportionment requirements of the Antideficiency Act of 1950 ("Antideficiency Act"), 31 U.S.C. §§ 1511-1519, to funds of the Federal Deposit Insurance Corporation ("FDIC"). By memorandum dated January 10, 1986, the Office of Legal Counsel ("OLC") of the Department of Justice concluded that the apportionment requirements may be applied to the nonadministrative expenses of the FDIC. The OLC memorandum does not address whether the administrative expenses of the FDIC are also subject to apportionment. The OLC memorandum was in response to a January 31, 1985 letter from the General Counsel of the Office of Management and Budget ("OMB") requesting OLC's views on whether "the apportionment provisions of the Antideficiency Act" apply to "the nonadministrative funds of the FDIC."^{1/}

Summary of Conclusions

In our judgment, the apportionment provisions of the Antideficiency Act do not apply to the FDIC for two independent reasons. First, the FDIC is not covered by the Antideficiency Act because it is a nonappropriated government corporation outside the

^{1/} It should be noted that even the OLC opinion--which the FDIC believes is in error--would not allow OMB to apportion any administrative funds of the FDIC. The OLC opinion applies by its terms to nonadministrative funds of the FDIC, and thus does not support any apportionment of any FDIC administrative funds.

executive branch. Second, Congress has directly addressed the question of whether the FDIC should be subject to executive branch budget supervision and, after comprehensive study, repeatedly refused to alter the 53-year history of FDIC independence.

When Congress created the FDIC, it provided for the funding of all FDIC expenses through statutory assessments upon all FDIC-insured banks. This system provided a means for insured banks mutually to guarantee the deposits of each other. See H.R. Rep. No. 150, 73d Cong., 1st Sess., 5 (1933). Congress did not provide for the FDIC to receive appropriated funds. 12 U.S.C. § 1817. Thus, since its creation in 1933, the FDIC has not been subject to the usual executive branch appropriations review process applicable to most governmental entities. If OMB were to implement OLC's conclusion, the budget process of a government corporation which Congress established as independent would become subject to potential executive branch interference.

Although OMB and its predecessor agencies have frequently recommended that Congress expand the role of OMB over the FDIC, OMB has never previously asserted authority by means of the Antideficiency Act. In order to reach the conclusion sought by OMB, OLC's conclusion is based upon a re-interpretation of a little-noted 1950 amendment to the Antideficiency Act. The OLC re-interpretation is not supported by the Act's language or its legislative history, or a comparison of FDIC with the Federal Savings and Loan Insurance Corporation ("FSLIC"). It is inconsistent with a variety of

statutes and other later expressions of congressional intent, and it ignores the thirty-six years of experience that Congress and the executive branch have had in interpreting the amendment.^{1/}

The Antideficiency Act of 1950 Does Not Address
the Budget Process of FDIC

The antideficiency provisions are contained in Chapter 15 of Title 31 of the U.S. Code. This chapter, entitled "Appropriations Accounting," is essentially inapplicable to the FDIC and other governmental entities that obtain operating funds through deposit assessments or trust-type funds and do not receive legislative appropriations.^{1/} The Antideficiency Act is directed at requiring appropriated agencies to apportion their spending and obligations throughout the fiscal year "to prevent obligation or expenditure at a rate that would indicate a necessity for a deficiency or supplemental appropriation for the period." 31 U.S.C. § 1512(a). It provides discipline for government officials of appropriated entities in the executive branch who obligate the United States

^{1/} The executive branch has always previously acknowledged that it does not have any authority over the budget of the FDIC. A recent OMB Circular No. A-11, § 11.1 (July 1985), for example, explicitly states that "the general policies, justification requirements, and instructions on additional data and hearings are not applicable to the budgets not subject to executive branch review. These include the legislative branch, the judiciary, the Federal Deposit Insurance Corporation...." (emphasis added)

^{1/} FDIC assessments establish a trust fund in part to provide a means for payment of depositors of failed insured banks. Trust-type funds of the FDIC are not subjects of appropriations or apportionment. 31 U.S.C. §§ 1321(b), 1516. See also S. Rep. No. 1195, 73d Cong., 2d Sess. (1933).

without regard to apportionment guidelines. 31 U.S.C.

§§ 1517-1519. It is not the principal statute governing the budget process of any governmental entity.

The Government Corporation Control Act Establishes
the Budget Process of Government Corporations

It is the comprehensive Government Corporation Control Act of 1945 ("GCCA") that establishes the degree of executive branch supervision over the budgets of government corporations. 31 U.S.C. 9101. Under GCCA, government corporations are divided into two categories: "wholly owned" and "mixed-ownership." The labels are not necessarily descriptive of the actual nature of ownership. Rather than providing standard definitions or criteria, the law simply enumerates the corporations included in each group. The FDIC is placed in the "mixed-ownership" group despite the fact that it does not now have any private ownership.⁴ FSLIC, although it has many characteristics in common with the FDIC, is classified as "wholly owned".⁵

⁴ The FDIC was created as a stock corporation and some of its stock was originally held by Federal Reserve banks and some by the United States Government. When the last of the FDIC's stock was retired in 1948, pursuant to law, the FDIC ceased to be owned in the usual sense of ownership. See Section 4 of the Act of August 5, 1947, Pub. L. No. 363, 61 Stat. 773.

⁵ Other "mixed-ownership" banking corporations, including the Regional Banks for Cooperatives, Federal Intermediate Credit Banks, and Federal Land Banks, are essentially privately owned. Their boards of directors represent primarily the private sector, and their capital stock is owned by private members or private associations. The U.S. Railway Association, which is primarily federal, is also classified as "mixed-ownership." See Comptroller General, Report to Congress: Congress Should Consider Revising Basic Corporate Control Laws, 11, 12 (1983).

The GCCA categorization is significant, however, in one important respect. Only "wholly owned" corporations are required to submit annual budgets for executive branch review. 31 U.S.C. § 9103. "Mixed-ownership" corporations, on the other hand, are not required to submit to executive branch budget oversight. To the contrary, Section 10(a) of the Federal Deposit Insurance Act ("FDI Act") gives the Board of Directors of the FDIC independent authority to "determine and prescribe the manner in which its obligations are incurred and its expenses allowed and paid." 12 U.S.C. § 1820(a).^{1/}

Independent budget authority enjoyed by "mixed-ownership" corporations has received repeated consideration over the years. OMB and its predecessor agencies have long advocated subjecting all government entities including the FDIC to the full range of budget controls, including executive budget supervision. Congress has reviewed this matter on a number of occasions, both in hearings and congressional reports. The attached appendix lists proposals which, if approved, would have accomplished greater executive branch supervision of the FDIC's budget. Yet Congress has refused to alter the existing independent process and subject the FDIC to executive

^{1/} The Federal Deposit Insurance Act was reenacted on September 21, 1950, two weeks after enactment of the 1950 amendments to the Antideficiency Act. Before then, the FDI Act was a part of 1933 amendments to the Federal Reserve Act, 12 U.S.C. § 264 (1940).

budget control. It has explicitly refused to place the FDIC in the "wholly owned" category of the GCCA which would subject the FDIC to executive branch budget review.^{1/}

As recently as the 1970s, Congress reaffirmed its desire to retain the "mixed-ownership" category as a vehicle to allow certain governmental entities financial independence.^{2/}

By refusing to amend the GCCA in the face of a number of OMB attempts, Congress has reaffirmed its intention to keep the FDIC free from any executive branch budget oversight. When Congress has refused to enact OMB's express proposals to amend the GCCA, OMB cannot be permitted to achieve budget control indirectly by using the Antideficiency Act.

Neither the Language nor the Legislative History of the Antideficiency Act Supports OMB Apportionment Authority

Contrary to OLC's assertion that the apportionment requirements of the Antideficiency Act apply to all government agencies "with

^{1/} See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess., 29,32 (1978), (statement of George LeMaistre, Director, FDIC).

^{2/} In response to the collapse of northeastern railroads, Congress created the U.S. Railway Association ("USRA") to oversee the organization and route selections of Consolidated Rail Corporation ("Conrail"). USRA is government controlled and funded by appropriations. It was purposefully defined as "mixed-ownership" to avoid subjecting it to the budget and other controls applicable to "wholly owned" corporations. Comptroller General, Report to Congress: Congress Should Consider Revising Basic Corporate Control Laws 11 n.1 (1983).

three narrow exceptions," the statute applies only to entities "in the executive branch" and to those receiving legislative appropriations. See 31 U.S.C. § 1513. OLC cites no authority--and indeed there is none--that defines the FDIC as an executive branch agency for any budgetary purpose.¹⁷

OLC's discussion analogizes the FDIC to the FSLIC. However, unlike the FDIC, the FSLIC is explicitly defined as being in the executive branch. 12 U.S.C. § 1437(b). Its statute distinguishes "nonadministrative expenses" from "administrative expenses"; because the FSLIC is part of the Federal Home Loan Bank Board ("FHLBB"), a ceiling on the FSLIC's administrative expenses is established through the appropriations process. FHLBB's administrative expenses have long been subject to the usual executive oversight of budget submissions pursuant to the GCCA, 31 U.S.C. § 9101, 1904. The 1983 OLC opinion concluded that FSLIC's nonadministrative expenses should also be subject to apportionment. The FDIC's statute, on the other hand, does not distinguish between nonadministrative expenses and administrative expenses.¹⁸

¹⁷ For a discussion of the Supreme Court's view of Congress' authority to create independent government corporations, see Keifer & Keifer v. Reconstruction Finance Corporation, 306 U.S. 516, 518 (1939).

¹⁸ A more apt analogy for budgetary purposes is between the FDIC and the Federal Reserve Board. Members of Congress have made this comparison in describing the FDIC's budgetary independence. Senator Vandenberg, one of the sponsors of the Banking Act of 1933 which created the FDIC, compared the FDIC to the Federal Reserve Board as follows:

The FDIC is on all fours with the Federal Reserve System with respect to the fiscal structure of the American economy. No one has yet had the temerity

There is no statutory basis for OLC's reliance on "logic" to characterize the FDIC as "partly owned by the United States" and therefore covered by the Antideficiency Act. The FDIC is controlled by the United States through the presidential appointment process, but is not legally "owned" in the usual sense of that term since the FDIC's capital stock was retired by an Act of Congress in 1948. Even assuming arguendo that the FDIC were "partly owned by the United States," it would still not be subject to executive apportionment because, as noted above, it is not "in the executive branch."

Moreover, even if the FDIC were within the executive branch, the FDIC is excluded from the apportionment process because it is a corporation which, among other activities, makes loans without legal liability on the part of the United States. See Garn-St Germain Depository Institutions Act of 1982, codified at 12 U.S.C. § 1823(c)(1). Such entities are specifically exempted from apportionment requirements. 31 U.S.C. § 1511(b)(2).

Footnote 10 continued

to propose that the Federal Reserve System should be robbed of its independence and subordinated to a political bureau of the Government. Yet here is an institution which is even more sensitive with respect to the necessities for its independence and we confront a conference report which for the first time proposes to make it possible for political controls to determine what happens.

93 Cong. Rec. 10123 (1949).

Senator Vandenberg's views were shared by a majority of Congress. The FDIC's budget independence was not changed in response to the referenced conference report proposal.

Similarly, the OLC conclusion is not supported by "legislative history". When Congress passed the Antideficiency Act of 1950, there were brief hearings held but no reports issued. The Act was passed as an amendment to an appropriations bill.¹¹ The "legislative history" cited consists of random comments by two legislators. Those comments are interspersed with comments by others on totally unrelated matters, including the alleged risk posed by communists and homosexuals in the State Department. Contrary to the OLC conclusion, it was not Congress' intent to alter the relationship between the executive and congressionally authorized independent agencies, since that issue was not even debated.¹²

Congressman Norrell, whose comments are highlighted by OLC, was apparently chiefly concerned about two matters: first, the sometimes irresponsible unapportioned spending by appropriated governmental entities; and second, the risk of government corporations obligating the federal government through their authorized but unapportioned borrowings from the U.S. Treasury. Nothing in his comments could be stretched to conclude that OMB should be authorized to apportion the FDIC's expenses. At most his comments could be interpreted as an expression of belief that FDIC

¹¹ General Appropriations Act, Pub. L. No. 81-759, § 1211, 64 Stat. 595, 765-767 (1951).

¹² Congress considered and rejected proposals which would have subjected FDIC to greater budget oversight in 1947, 1949, 1950, 1958, 1960 and 1978. See attached appendix.

should be required to apportion its use of its authority to borrow from the U.S. Treasury pursuant to 12 U.S.C. § 1824.^{11/}

Congressman Keefe's comments, the only other "legislative history" cited by OLC, are particularly inapposite. He was concerned solely about the lack of congressional budget oversight of corporations. His comments do not support executive apportionment oversight.

This scant "legislative history" is far less persuasive evidence of congressional intent than subsequent congressional rejection of explicit proposals to subject FDIC to executive budget oversight. See attached Appendix.

The 1950 Amendments to the Budget and Accounting Act Support the Conclusion That FDIC Funds Are Not "Appropriations" as Used in the Antideficiency Act

The Budget and Accounting Act of 1921 governs the budget process of government agencies not covered by the GCCA or other legislation. Like the Antideficiency Act, it includes the term "funds" as one of the definitions of "appropriations". The

^{11/} With regard to the FDIC, Congressman Norrell specified \$3 billion, the amount the FDIC was then and is now authorized to borrow pursuant to 12 U.S.C. § 1824, as the figure that arguably might be subject to the Antideficiency Act. The FDIC has never used or projected the need to use the \$3 billion line of credit. Further, if the FDIC were to draw on that line of credit, such a loan would not create a legal liability on the part of the United States. The obligation would be a debt of the FDIC payable to the U.S. Treasury. The existence of the line of credit does not constitute a present or actual legal liability of the United States. See e.g., 77 Cong. Rec. 3729 (May 19, 1933) (statement of Sen. Glass); 77 Cong. Rec. 3964-3965 (May 22, 1933) (statement of Rep. Ayers); H.R. Rep. No. 150, 73d Cong., 1st Sess. 5 (1933); FDIC v. Stensland, 15 N.W. 2d 8 (S.D. 1944).

legislative history of the 1950 Amendments to the Budget and Accounting Act resolves any question about whether the FDIC's assessments and income are such "funds." The Conference Report states:

The funds of the Federal Deposit Insurance Corporation are received from assessments on insured banks and are used only for the purposes of deposit insurance. These funds have never been under the Budget and Accounting Act for the reason that they are not Government moneys or appropriations and there was no intention of including such funds.... (emphasis added)

Conf. Rep. No. 3002, 81st Cong., 2d Sess., reprinted in 1950 U.S. Code Cong. Service, 3729, 3730.

OMB Apportionment Authority Is Inconsistent With FDIC Independence

Exercise of apportionment power by OMB is inconsistent with many other congressional actions designed to insulate the FDIC from executive control.¹⁴ For example, in 1974 Congress enacted legislation that prohibits the executive branch from screening the FDIC's (and other financial institution regulators') legislative recommendations, or testimony, or comments on legislation prior to submission to Congress. 12 U.S.C. § 250. The congressional purpose in enacting this section was to "preserve and strengthen the independence of these agencies, which were originally created by

¹⁴ Our prior memorandum discusses this point in considerable detail at p. 5-10. For convenience, a copy of our earlier memorandum is attached.

Congress to be free of control by the executive branch." "Because Congress delegated its own legislative power to these independent agencies, it is important to prevent executive usurpation of their powers." Independence from the executive branch was necessary if the agencies were to be "effective in their vital role of preserving the integrity of our financial institutions."¹¹

When Congress enacted the Garn-St Germain Depository Institutions Act of 1982 to give the FDIC expanded authority, flexibility, and discretion to assist failing institutions, it specified that such assistance decisions be made independently without review by the executive branch. The Act specifies that:

The Corporation is authorized, in its sole discretion and upon such terms as the Board of Directors may prescribe, to make loans to, to make deposits in, to purchase the assets or securities of, to assume the liabilities of, or to make contributions to, any insured bank ***
(Emphasis added).

12 U.S.C. § 1823(c)(1) (1985).

Executive control of the budget process, even so far as apportionment is concerned, poses at least as great a risk to FDIC independence as executive review of legislative recommendations or assistance transactions.

¹¹ S. Rep. No. 93-902, 93rd Cong., 2d Sess. 11, reprinted in [1974] U.S. Code Cong. & Ad. News 6129. (Emphasis added).

In Humphrey's Executor v. United States, 295 U.S. 602 (1935), the Supreme Court considered the proper role of the executive branch over congressionally established independent governmental entities. That case held that a commissioner of an independent agency cannot be removed because of his policy viewpoints. Commissioner Humphrey of the Federal Trade Commission was asked to resign by President Franklin D. Roosevelt. The Supreme Court, in ruling the removal of the commissioner unconstitutional, stated that:

the language of the act, the legislative reports, and the general purposes of the legislation as reflected by the debates, all combine to demonstrate the congressional intent to create a body of experts who shall gain experience by length of service -- a body of experts which shall be independent of executive authority, except in its selection, and free to exercise its judgment without the leave or hindrance of any other official or any department of the government. ... Its duties are performed without executive leave and, in the contemplation of the statute, must be free from executive control.

295 U.S. at 625-626. See also Wiener v. United States, 357 U.S. 349 (1958).

Conclusion

There is no sound legal basis to apply the Antideficiency Act apportionment provisions to the FDIC and inject the executive branch into the budget decisions of the FDIC.

APPENDIX

Partial Chronology of Prior Consideration of
Increasing Executive Budget Oversight Over the FDIC

- 1945 In enacting the comprehensive Government Corporation Control Act, Congress designated the FDIC as "mixed-ownership" and did not include a requirement that FDIC participate in the appropriations process. See Government Corporation Control Act: Hearing on S.469 Before the Subcommittee of the Senate Committee on Banking and Currency, 79th Cong., 1st Sess. (1945) (statement of Leo T. Crowley, Chairman, FDIC).
- 1947 Budget Control Act - The Senate rejected provision to subject the FDIC to the appropriations process by vote of 83 to 1. H.R. 3756, 80th Cong., 1st Sess. (1947). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 30 (1978) (statement of George LeMaistre, FDIC Director).
- 1949 The House of Representatives rejected a proposal to subject the FDIC to the appropriations process. H.R. 4177, 81st Cong., 1st Sess (1949). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 31 (1978) (statement of George LeMaistre, FDIC Director).
- 1950 A House of Representatives Report expressly excluded the FDIC from the appropriations bill because the FDIC's funds, i.e., assessments on insured banks, were not Government moneys and were used only for deposit insurance. H.R. Rep. No. 303 81st Cong. 2d Sess. (1950). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 32 (1978) (statement of George LeMaistre, FDIC Director).
- 1958 Hearings were held on proposal to subject the FDIC to the appropriations process. No action taken. Amending the Government Corporation Co. Act: Hearings on H.R. 8332 Before a Subcommittee of the Committee on Government Operations, 85th Cong., 2d Sess. (1958) (statement of Rep. Patman).
- 1960 Hearings were held on proposal to subject the FDIC to the appropriations process. No action taken. Making the Federal Deposit Insurance Corporation Subject to Annual Budget Review: Hearings on H.R. 12092 Before a Subcommittee of the Committee on Government Operations, 86th Cong., 2d Sess. (1960).

- 1960 A proposal to subject the FDIC to the appropriations process was never reported out of committee. H.R. 12092, 86th Cong., 2d Sess. (1960). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 32 (1978) (statement of George LeMaistre, FDIC Director).
- 1961 A proposal to subject the FDIC to the appropriations process was never reported out of committee. H.R. 6810, 87th Cong., 1st Sess. (1961). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 32 (1978) (statement of George LeMaistre, FDIC Director).
- 1965 A proposal to subject the FDIC to the appropriations process was never reported out of committee. H.R. 10507, 89th Cong., 2d Sess. (1965). See Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. 32 (1978) (statement of George LeMaistre, FDIC Director).
- 1967 Report of the President's Commission on Budget Concepts advocated reforms including subjecting the FDIC to appropriations process. See, The Report of the President's Commission on Budget Concepts, 30 (1967).
- 1977 A proposal to subject the FDIC to the appropriations process was the subject of hearings but no action was taken. Bank Supervision, Bank Directors and Conflicts of Interest: Hearings on S.71 Before the Committee on Banking, Housing, and Urban Affairs, 95th Cong., 2d Sess. (1978).
- 1983 Study suggests comprehensive reform of laws governing government corporations including subjecting them to greater budget supervision. No action taken. Comptroller General, Report to Congress: Congress Should Consider Revising Basic Corporate Control Laws (1983).



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUN 03 1986

Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance,
and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I want to apprise you of the strong opposition of the Office of Management and Budget to H.R. 3567, the "Depository Institution Examination Improvement Act of 1986" and a revised discussion draft of the bill, dated May 22, 1986.

The Department of the Treasury has given you its views on H.R. 3567. I will confine my remarks to certain provisions of the legislation currently before the subcommittee that are of the most immediate concern to OMB. I urge the subcommittee, in addition, to obtain and consider the views of the Department of Justice and the Office of Personnel Management, as well as any additional views of the Department of the Treasury, before acting on this bill. I should note here that OMB fully shares the Treasury's opposition to any proposal that would eliminate the Treasury Secretary's authority to provide "general directions" to the Office of the Comptroller of the Currency. As the Treasury Department noted in its May 9th letter, this authority has existed since 1863 and is important to the management of that Department.

Compensation of Federal Examiners

The Administration opposes the further exemption of the officers and employees of the financial institution regulatory agencies from the laws and regulations that are otherwise applicable to Federal employees. Existing law already gives each of these agencies significant flexibility in hiring and compensating their professional staffs. The President has recognized that piecemeal changes in this area are undesirable and recently proposed a new Government-wide personnel compensation system that would be phased-in over a period of time. Several features of this system would afford the

regulatory agencies additional flexibility to tailor compensation packages to fit their individual needs. Our position on this legislation, however, does not preclude further consideration of such changes as may be proposed by the Administration in the context of recommendations by the Task Group on Regulation of Financial Services (the so-called Bush Task Force).

Independent Agency Status

The Administration also opposes the features of this legislation that would make the regulatory agencies more "independent" of the Executive branch than they may already be. These features would exempt the agencies from otherwise applicable budget, staffing, appropriations, and apportionment requirements. Part of the underlying rationale for these proposals appears to be predicated upon a belief that congressional and Executive branch oversight of the kind applicable to other agencies is inappropriate and unwarranted because the operations of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the Comptroller of the Currency, among others, are funded through assessments on depository institutions. I am firmly convinced that these features of the legislation are shortsighted and ignore the overall context in which Executive branch budget policy is formulated and executed.

Presidential oversight of the regulatory agencies' funds is critical because of the direct impact on the budget, should it ever become necessary, of backing up the deposit insurance funds with the resources of the Treasury. Significant Federal outlays could also result if the contingent liabilities incurred in resolving the problems of troubled depository institutions ever materialize as actual costs. Concerns of this nature are especially pertinent during this period, as banks and thrifts adjust to a changing environment. I believe that Executive branch oversight of financial regulatory activities and the deposit insurance system, through the apportionment process, ensures that assessments collected from depository institutions are adequate and that they are used in a manner that is consistent with uniform budget concepts.

That an agency is not funded by direct appropriations in no way negates the need for Presidential direction and control. Assessments levied upon banks and thrifts are user fees for services that the Government provides these institutions, including chartering, examination, supervision, and insurance. These fees are collected in part to finance the deposit insurance system which is backed by the Federal Government. Indeed, these assessments are similar to fees that other agencies impose for services rendered. Fees are included in the budget; increases in funds collected reduce the deficit, while increased agency outlays add to it.

Simply put, it is very difficult to discern any valid reason for differentiating between depository institution regulatory agencies and other Federal agencies for budget purposes. Indeed, one could argue that the public's confidence in the stability of the Federal deposit insurance system rests, at least in part, upon a belief that the regulatory agencies are part of the Federal Government. A perception that the agencies are not part of the Government could erode that confidence.

Gramm-Rudman- Hollings Treatment

OMB also objects to the exemption of the depository institution regulatory agencies retroactively for 1986 from the requirements of the Balanced Budget and Emergency Deficit Control Act. This proposal would set an obviously undesirable precedent, which could lead to similar requests from other Federal agencies. The projected outlays of the regulatory agencies were used in calculating the base from which the 1986 sequestration percentage was determined. A retroactive exemption would effectively constitute a supplemental 1986 appropriation to these agencies of previously-sequestered amounts. These objections would not apply, of course, should Congress elect to exempt these agencies from Gramm-Rudman-Hollings prospectively (i.e., for fiscal year 1987 and thereafter).

Conclusion

In my view, each agency of the Executive branch, whatever its mission and constituency, and however funded, must be fully accountable to the elected representatives of the American taxpayers, the President and the Congress. To do otherwise -- to enact this legislation, for example -- would seriously impair that accountability and unwisely interfere with the President's authority to manage the Executive branch.

For these reasons, OMB strongly opposes this legislation.

Sincerely yours,


James C. Miller III
Director

c: Honorable Chalmers P. Wylie

Chairman HUBBARD. Thank you very much, the Honorable Bill Seidman, Chairman of the Federal Deposit Insurance Corporation.

We now call upon another witness but, please, before I do that, let me welcome to our subcommittee meeting our ranking minority member, who was delayed in his office, Congressman Stan Parris of Virginia. We appreciate his assistance, helpfulness, and leadership on this subcommittee; and also Congressman Steve Bartlett of Texas. We appreciate your joining us.

And now, the Honorable Edwin J. Gray, Chairman of the Federal Home Loan Bank Board. We welcome you and now hear your testimony.

STATEMENT OF THE HON. EDWIN J. GRAY, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. GRAY. Thank you very much, Mr. Chairman, and distinguished members of the subcommittee.

I appreciate the opportunity to discuss with you the impact of the reductions mandated by the Balance Budget and Emergency Deficit Control Act of 1985—"Gramm-Rudman-Hollings"—on the ability of the Federal Home Loan Bank Board and the FSLIC to supervise, examine, and generally oversee the operations of the thrift industry in the United States.

In addition, I have offered my views on the apportionment process under the Anti-Deficiency Act as it pertains to the Bank Board and the FSLIC.

The new powers available to FSLIC-insured thrift institutions demand two responses from the Bank Board.

We must administer a strong and healthy insurance fund that will permit the FSLIC maximum flexibility in coping with failed or failing thrifts. Recapitalization of the FSLIC, which the Bank Board seeks along with the Treasury, will not, in and of itself, accomplish the task.

We must have the ability to effectively oversee and supervise the federally-insured institutions for which we are responsible. We cannot protect the financial resources of the FSLIC without adequate human resources to do so. Those resources will be unavailable if the Board and the FSLIC are not funded adequately to ensure the support we need.

Thus, the challenge we face is this. We must respond with redoubled effort to the need for effective, sure, and timely supervision of all FSLIC-insured institutions, while simultaneously coping with the possibility of dramatic reductions in our funding. The Gramm-Rudman-Hollings Act would cause that reduction over time.

I believe it is important, therefore, for the Congress to review alternatives for reducing the impact of Gramm-Rudman-Hollings on the financial regulatory agencies. As you know, the Bank Board and the FSLIC are funded by offsetting collections from nonfederal sources. No tax revenues go to either account.

Section 18(b) of the Federal Home Loan Bank Act authorizes the Bank Board to levy semiannually upon the Federal Home Loan Banks an assessment sufficient to provide for payment of its expenses for the succeeding 6 months. These assessments go into the Bank Board Revolving Fund. It always has an approximately zero

net outlay balance because the assessments are approximately equal to the portion of the Bank Board's expenses they fund; any excess collected or deficiency left is credited or debited against the subsequent assessment. The Federal Home Loan Banks, in turn, derive their funds from earnings on loans and services they provide their member institutions.

In addition, the Bank Board is reimbursed by the FSLIC for services and facilities the Bank Board provides to it. Long ago, the Bank Board and the FSLIC consolidated support services in an effort to provide greater efficiency and economy to our operations. As a result, the FSLIC relies upon the Bank Board offices for much of its services and facilities, including legal, accounting, data processing, and many other aspects of support.

The FSLIC, like the FDIC, is funded by insurance premiums, assessments, and admission fees, authorized by the National Housing Act and collected from the institutions whose accounts it insures, and by income received from investment of these moneys. The Federal Government's initial investment in the FSLIC, as well as in the Federal Home Loan Bank System, was fully retired in the 1950's. Since that time, operations of the Bank Board, the FSLIC, and the Bank System have been financed as I have just described.

As this description makes clear, a reduction in the administrative expenses of the Bank Board and the FSLIC will not create surplus revenues to apply to the deficit or to fund other Government activities. Thus, the rationale and purpose of Gramm-Rudman-Hollings are not served by applying its provisions to the Bank Board or to the FSLIC.

If, despite the clear separation of Bank Board and FSLIC moneys from general tax revenues, Gramm-Rudman-Hollings is applied to the Bank Board and the FSLIC, the consequences for the FSLIC can only be harmful.

Applying 4.3 percent the fiscal year 1986 sequester percentage—to the Bank Board's and the FSLIC's fiscal year 1986 congressional limitations, the Congressional Budget Office, OMB and the Government Accounting Office determined that for fiscal year 1986 the amounts to be sequestered are \$1,156,000 for the Bank Board and \$62,000 for the FSLIC or a total of \$1,218,000.

The Gramm-Rudman-Hollings Act prescribes a maximum deficit amount of \$144 billion for fiscal year 1987. Recent estimates of the fiscal year 1987 deficit range from \$30 to \$60 billion above this amount. Correspondingly, the potential sequester percentage could range from 12 to 25 percent. If the amount to be sequestered in fiscal year 1987 is 20 percent or more, assuming that the Bank Board's and the FSLIC's fiscal year 1987 congressional administrative expense limitation is the base subject to sequestration, this would mean a decrease in Bank Board, FSLIC administrative expenses of \$5.5 million or more, depending on the amount of the sequester.

A cut of the magnitude currently estimated for fiscal year 1987 would seriously impair the effectiveness of the Bank Board and certainly harm the FSLIC. Because 75 percent of our administrative expenses fund salaries and related benefits and most of the rest are related fixed costs, such as building operation expenses, even a rel-

atively small reduction will force immediate staffing reductions in critical areas that the FSLIC requires for daily support functions.

Cutting the FSLIC's expenses will force it to delay critical default prevention and liquidation activities, with the likely result that the cost of those activities will be much higher when the problems are finally resolved. In other words, cutting the FSLIC's expenses, however broadly or narrowly defined, will not decrease the FSLIC's ultimate liabilities and related outlays. Instead, the opposite is likely to occur.

Even if the exemption in section 255(g)(2) of the act were interpreted to exempt the FSLIC completely from the sequestration process, the act would still adversely impact the FSLIC because it relies upon Bank Board offices for many of its services and facilities. As a result, a cut in the Bank Board's administrative expenses implicitly means a cut in resources for the FSLIC at a time when the problems facing FSLIC-insured institutions demand increased, rather than decreased, resources for the FSLIC if it is to fulfill its legal obligations. As I suggested earlier, the FSLIC recapitalization bill is one method of assisting the FSLIC to do so. The effectiveness of that legislation will be gravely compromised, however, if as a result of inadequate resources and support, the FSLIC is unable to conduct timely and effective case resolutions.

I strongly urge the committee to use its good offices to assist us in removing the Bank Board and the FSLIC from the Gramm-Rudman-Hollings sequestration process. Its application to us makes no sense, given the way both the Bank Board and the FSLIC are funded and the fact that sequestration of part of our funds will not help lessen the deficit in any possible way. Furthermore, the act specifically exempts insurance payments and other contractual obligations of the FSLIC from sequestration. Since the FSLIC's workload, as well as that of the portion of the Bank Board which supports the FSLIC, is determined directly by the size of these exempt payments, it logically follows that the administrative expenses necessary to carry out these functions should be similarly exempt. Finally, as I have explained, the cuts required by Gramm-Rudman-Hollings will cripple our efforts to restore the thrift industry to safety and soundness and safeguard and strengthen the FSLIC insurance fund.

In the interest of time, I have also included in my prepared statement—which was submitted to you yesterday—the Bank Board's views on apportionment.

I stand ready and would be very pleased to answer your questions.

Thank you.

[The prepared statement of Mr. Gray follows:]

STATEMENT OF
EDWIN J. GRAY
CHAIRMAN, FEDERAL HOME LOAN BANK BOARD
BEFORE THE
SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
JUNE 17, 1986

Mr. Chairman and distinguished members of the Subcommittee:

I appreciate the opportunity to discuss with you the impact of the reductions mandated by the Balanced Budget and Emergency Deficit Control Act of 1985 ("Gramm-Rudman-Hollings"),^{1/} on the ability of the Federal Home Loan Bank Board ("Bank Board") and the Federal Savings and Loan Insurance Corporation ("FSLIC") to supervise, examine, and generally oversee the operations of the thrift industry. In addition, I am pleased to offer my views on the apportionment process under the Anti-Deficiency Act^{2/} as it pertains to the Bank Board and to the FSLIC.

Impact of Gramm-Rudman-Hollings

The new powers available to FSLIC-insured thrift institutions demand two responses from the Bank Board. We must administer a strong and healthy insurance fund that will permit the FSLIC maximum flexibility in coping with failed or failing thrifts. The recapitalization of the FSLIC which the Bank Board seeks will not, in and of itself, accomplish the task.

We must have the ability to effectively oversee and supervise the federally-insured institutions for which we are responsible. We cannot protect the financial resources of the FSLIC without adequate human resources to do so. Those resources will be unavailable if the Board and the FSLIC are not funded adequately to ensure the support we need. Thus, the challenge we face is this. We must respond with redoubled effort to the need for effective, sure, and timely supervision of all FSLIC-insured institutions, while simultaneously coping with the possibility of dramatic reduction in our funding. The Gramm-Rudman-Hollings Act would cause that reduction over time.

I believe it is important, therefore, for The Congress to review alternatives for reducing the impact of Gramm-Rudman-Hollings on the financial regulatory agencies. As you know, the Bank Board and the FSLIC are funded by offsetting collections from non-federal sources. No tax revenues go to either account.

Section 18(b) of the Federal Home Loan Bank Act^{3/} authorizes the Bank Board to levy semiannually upon the Federal Home Loan Banks an assessment sufficient to provide for payment of its expenses for the succeeding six months. These assessments go into the Bank Board Revolving Fund, which always has an approximately zero net outlay balance because the assessments are approximately equal to the portion of the Bank Board's

^{1/} Pub. L. No. 99-177, 99 Stat. 1038 (1985).

^{2/} 31 U.S.C. §§ 1511-1519 (1982).

^{3/} 12 U.S.C. § 1438(b) (1982).

expenses they fund; any excess collected or deficiency left is credited or debited against a subsequent assessment. The Federal Home Loan Banks, in turn, derive their funds from earnings on loans and services they provide their member institutions.

In addition, the Bank Board is reimbursed by the FSLIC for services and facilities the Bank Board provides to it. Long ago, the Bank Board and the FSLIC consolidated support services in an effort to provide greater efficiency and economy to our operations. As a result, the FSLIC relies upon Bank Board offices for much of its services and facilities, including legal, accounting, data processing, and other support.

The FSLIC, like the Federal Deposit Insurance Corporation, is funded by insurance premiums, assessments, and admission fees, authorized by the National Housing Act^{4/} and collected from the institutions whose accounts it insures and by income received from investment of these monies. The federal government's initial investment in the FSLIC, as well as in the Federal Home Loan Bank System, was fully retired in the 1950's. Since that time, operations of the Bank Board, the FSLIC, and the Bank System have been financed as I have just described.

As this description makes clear, a reduction in the administrative expenses of the Bank Board and the FSLIC will not create surplus revenues to apply to the deficit or to fund other government activities. Thus, the rationale and purpose of Gramm-Rudman-Hollings are not served by applying its provisions to the Bank Board or to the FSLIC.

If, despite the clear separation of Bank Board and FSLIC monies from general tax revenues, Gramm-Rudman-Hollings is applied to the Bank Board and the FSLIC, the consequences for the FSLIC can only be harmful.

Applying 4.3% (the FY-1986 sequester percentage) to the Bank Board's and the FSLIC's FY-1986 Congressional limitations, the Congressional Budget Office, the Office of Management and Budget, and the Government Accounting Office determined that for FY-1986 the amounts to be sequestered are \$1,156,000 for the Bank Board and \$62,000 for the FSLIC or a total of \$1,218,000.

The Gramm-Rudman-Hollings Act prescribes a maximum deficit amount of \$144 billion for FY-1987. Recent estimates of the FY-1987 deficit range from \$30 to \$60 billion above this amount. Correspondingly, the potential sequester percentage could range from 12% to 25%. If the amount to be sequestered in FY-1987 is 20% or more, assuming that the Bank Board's and the FSLIC's FY-1987 Congressional administrative expense limitation is the

^{4/} 12 U.S.C. §§ 1726(d), 1727(b) and (c) (1982).

base subject to sequestration, this would mean a decrease in Bank Board/FSLIC administrative expenses of \$5.5 million or more, depending upon the amount of the sequester.

A cut of the magnitude currently estimated for FY-1987 would seriously impair the effectiveness of the Bank Board and certainly harm the FSLIC. Because 75% of our administrative expenses fund salaries and related benefits and most of the rest are relatively fixed costs, such as building operation expenses, even a relatively small reduction will force immediate staffing reductions in critical areas that the FSLIC requires for daily support functions.

Cutting the FSLIC's expenses will force it to delay critical default prevention and liquidation activities, with the likely result that the cost of those activities will be much higher when the problems are finally resolved. In other words, cutting the FSLIC's expenses, however broadly or narrowly defined, will not decrease the FSLIC's ultimate liabilities and related outlays. Instead, the opposite is likely to occur.

Even if the exemption in Sec. 255(g)(2) of the Act were interpreted to exempt the FSLIC completely from the sequestration process, the Act would still adversely impact the FSLIC because it relies upon Bank Board offices for many of its services and facilities. As a result, a cut in the Bank Board's administrative expenses implicitly means a cut in resources for the FSLIC at a time when the problems facing FSLIC-insured institutions demand increased, rather than decreased, resources for the FSLIC if it is to fulfill its legal obligations. As I suggested earlier, the FSLIC recapitalization bill is one method of assisting the FSLIC to do so. The effectiveness of that legislation will be gravely compromised, however, if as a result of inadequate resources and support, the FSLIC is unable to conduct timely and effective case resolutions.

I strongly urge the Committee to use its good offices to assist us in removing the Bank Board and the FSLIC from the Gramm-Rudman-Hollings sequestration process. Its application to us makes no sense, given the way both the Bank Board and the FSLIC are funded and the fact that sequestration of part of our funds will not help lessen the deficit in any way. Furthermore, the Act specifically exempts insurance payments and other contractual obligations of the FSLIC from sequestration. Since the FSLIC's workload, as well as that of that portion of the Bank Board which supports the FSLIC, is determined directly by the size of these exempt payments, it logically follows that the administrative expenses necessary to carry out these functions should be similarly exempt. Finally, as I have explained, the cuts required by Gramm-Rudman-Hollings will cripple our efforts to restore the thrift industry to safety and soundness and safeguard and strengthen the FSLIC insurance fund.

Apportionment

I would like to discuss briefly the Bank Board's position on the apportionment process. As you know, this process as mandated by the Anti-Deficiency Act is basically an accounting mechanism to ensure that budgetary resources are not exceeded and that budgeted funds in various categories are applied efficiently throughout the applicable fiscal period. Under this process, the OMB's prior approval is required for an agency to exceed the amount apportioned to any category of funds or to shift funds between categories.

Unlike the FDIC and the OCC, which are testifying with us today, the Bank Board and the FSLIC have previously been subjected to the apportionment process. Although Bank Board General Counsels have for many years been of the opinion that the FSLIC's nonadministrative expenses were not subject to apportionment, the applicable statutes on this subject are not clear. Because the FSLIC needs the ability to react quickly to imminent thrift failures without the procedural delays inherent in the apportionment process, apportionment has been an issue of much contention between the FSLIC and the OMB.

Last year, with the help of the White House Counsel to the President, we reached an agreement with the OMB to simplify the manner in which the apportionment process is applied to the FSLIC Fund. The new procedure gives the FSLIC some improvement in flexibility so that it can respond quickly to financial emergencies, but the OMB still apportions the FSLIC Fund across four separate categories.

Even though the number of categories was reduced from eleven to four, in two of these categories, FSLIC Cash Program Assistance and FSLIC Non-Cash Program Assistance, the OMB tries to distinguish between the type of assistance the FSLIC may provide as part of a default prevention action. Many assistance packages involve both kinds of assistance, and it is difficult to predict in advance what combination and what amount of each form of assistance will be needed for a particular fiscal year's default prevention actions. For this reason, I believe the Bank Board and the FSLIC should be free from the apportionment process altogether, just as the FDIC, our sister insurer, is and should continue to remain free of that process.

Thank you very much. I will be pleased to try to answer any questions the Subcommittee may have.

Chairman HUBBARD. Thank you very much, Chairman Gray.

Last, we call on our third witness, Hon. Robert L. Clarke, Comptroller of the Currency, for his testimony. Upon the completion of his remarks, we will then begin asking questions of the three of you, collectively and individually.

Mr. Clarke.

STATEMENT OF HON. ROBERT L. CLARKE, COMPTROLLER OF THE CURRENCY

Mr. CLARKE. Mr. Chairman and members of the subcommittee, thank you for the opportunity to appear before you to discuss the effects of the Deficit Reduction Act of 1985, known as Gramm-Rudman-Hollings, on the Office of the Comptroller of the Currency (OCC) and its ability to supervise, examine, and generally oversee the operations of the national banking system. As you suggested in your invitation, these cuts are affecting our ability to supervise effectively the national banking system, and I will explain to you this morning why this is the case.

I have submitted a written statement and would ask your permission that it be included in the record.

Chairman HUBBARD. Is there objection?

[No response.]

Hearing none, so ordered.

Mr. CLARKE. The OCC was organized in 1863 as a self-supporting bureau of the Department of the Treasury under the general supervision of the Secretary. As you know, this Office is charged with supervision and regulation of the Nation's nationally chartered banks. It receives no appropriations and operates without any tax moneys. The Office is funded entirely from assessments levied on national banks, application fees and investment income.

Congress has recognized how important a sound banking industry is to the well-being of the Nation and granted the bank regulatory agencies a measure of independence to protect their decision-making processes.

Specific statutory grants of authority authorize the Comptroller to conduct bank examinations as often as he deems necessary and to determine the amounts of money to be assessed and expended for those examinations. The statute states that these moneys "shall not be construed to be Government funds or appropriated moneys." Consequently, unspent OCC funds cannot be diverted to any other use. They remain a part of our general funds and may be spent later or may be returned to the national banks. Application of Gramm-Rudman-Hollings reductions to the OCC threatens OCC's effectiveness as a bank supervisor and will not result in any impact whatsoever on the Federal budget deficit.

The Comptroller's Office must have the necessary flexibility to set appropriate levels of supervision for the individual banks and for the industry as a whole. The quality and amount of supervision must be determined by the OCC's judgment about economic conditions and conditions within the industry.

Since the early 1980's, trends in the Nation's financial system have made OCC's mission more challenging, demanding not only more resources but also more efficient use of those resources.

It is widely understood that the banking system is under pressure. Last year, of the approximately 15,000 commercial banks, 118 failed, the most in any year since the Great Depression. Thirty of the 118 were national banks. At least that many failures are expected in 1986. As of last Friday, 57 banks had failed, of which 21 were supervised by OCC.

The pressures on the industry, however, extend beyond the number of bank failures. For the industry as a whole, profitability is declining. Although the majority of the banking industry continues to generate adequate earnings, there is a growing minority of commercial banks with earnings that can only be characterized as poor. For the 4,500 national banks with assets of less than \$300 million, the average return on assets has declined in each of the past 6 years. The number of national banks with losses has risen dramatically. In 1980, 3 percent had losses; in 1985, 16 percent had losses.

These pressures have significantly increased the demands on OCC resources. The number of national banks receiving special supervisory attention has quadrupled since 1980. Currently, 21 percent of all national banks have composite ratings of 3, 4, or 5 and are receiving special supervisory attention. The resources needed to supervise the national banking system are greater now than at any time in the last 50 years.

In addition to the increased pressures on the industry's performance, the national banking system has grown, both in numbers of banks and in assets. In 1979, there were 4,400 national banks. Today there are approximately 5,000, and the number is growing. In 1979, total national bank assets were \$996 billion. At the end of 1985, they totaled \$1.6 trillion.

To meet the increased demands of supervision and regulation within the limits of available resources, OCC has pursued a strategy adopted in 1981 which utilizes technology and innovative procedures for offsite monitoring of bank performance. As a result, resource intensive onsite examinations can be directed at the institutions that present the greatest risks to the safety and soundness of the entire banking system. As part of our 1986 supervisory plan, for instance, we decided to forgo onsite examinations at 1,200 community national banks that had been identified through offsite analysis as posing the least risk to the banking system.

Despite our best efforts, the OCC simply needs more examiners because of the increased number of banks and the overall conditions in the national banking system. The need for additional examiners was recognized by the Treasury Department which requested 150 additional full-time equivalents for the OCC in fiscal year 1987. That increase was proposed in the President's 1987 budget and demonstrates the administration's commitment to addressing the problems.

The impact of the Gramm-Rudman-Hollings reductions in fiscal year 1986 is twofold. First, the reductions restrict expenditures for programs and projects necessary to fulfill OCC's supervisory strategy. Second, in spite of our effort to reduce expenses without reducing personnel, the 4.3-percent sequestration for fiscal year 1986 has resulted in staff reductions below levels which, in our judgment, are necessary to carry out our mission.

The OCC is a people-intensive organization primarily composed of examiners, 80 percent of whom are involved in bank supervision. The OCC's investment in its employees is substantial. The bank examiner position is an apprentice occupation. It costs OCC more than \$30,000, exclusive of compensation, to train an examiner to become a commissioned National Bank Examiner by the 5th or 6th year of employment. Once trained, the examiners are in great demand by the financial industry. As a result, OCC experiences a substantial turnover rate, averaging about 14 percent over the last 5 years.

Because of the OCC's high turnover rate, we must keep up a steady process of recruitment and training. When that process is interrupted as it was this year by Gramm-Rudman-Hollings, it becomes a problem for us several years in the future when the experienced examiners will be in short supply.

The OCC's supervisory strategy requires investment in both facilities and automation. Off-site supervision relies on bank financial data, generated from sources such as the bank call reports and analyzed through supervisory information systems, to determine the degree of bank stability and to pinpoint particular areas of weakness. On-site activity is then focused on these specific areas of concern.

Although off-site supervision reduces resource needs and travel costs, space must be provided for examiners to work and information systems must be designed, implemented and maintained to provide the tools for their analytical efforts. Curtailment of facilities and automation will inhibit our future supervisory efforts or increase resource demands, because we cannot achieve the efficiencies inherent in our off-site strategy.

Although OCC maintains that it should not be subject to Gramm-Rudman-Hollings, it has adopted a program to reduce expenditures in fiscal year 1986. This program was based on three guiding principles: first, maintenance of supervisory resources at the highest possible level; second, minimizing the impact on current employees to avoid an increase in turnover and the loss of experienced examiners; and third, maintenance of at least minimal investment in programs that provide future cost savings or efficiencies in resource usage.

All projected expenditures were evaluated in the context of these guidelines. However, the Gramm-Rudman-Hollings mandated reductions are so significant that only 60 percent of the reductions can be achieved by reducing nonpersonnel-related expenditures.

To meet Gramm-Rudman-Hollings targets, it was necessary to reduce staff resources through the implementation of a hiring freeze and, potentially, through furloughs, the least harmful ways to achieve personnel cost savings. A recent analysis of the staff reduction which resulted from our hiring freeze indicates that:

The freeze will reduce the number of field examiners in bank supervision by 275 during fiscal year 1986.

Approximately 700 community national banks will not receive planned on-site supervision in 1986.

And, of these 700, over 100 are community banks that have been identified as likely to suffer a deterioration in their financial condition.

The 700 community banks are in addition to the 1200 community banks not planned for on-site supervision in 1986. The on-site supervision program for community banks has been curtailed to direct our limited resources to the areas of highest risk.

The Gramm-Rudman-Hollings reductions for fiscal year 1986 are currently hindering the OCC's efforts to achieve fully our supervisory mandate at a time when the banking system is subject to significant pressures. Although the 1986 cuts are manageable, future cuts, if required, will severely impair our ability to supervise national banks. Accordingly, the administration favors Congress reconsidering the applicability of Gramm-Rudman-Hollings to the bank supervisors for fiscal year 1987 and beyond.

Congress has always taken very special care to insulate the bank supervisors from forces that run contrary to our primary mission of fostering the safety and soundness of the national banking system.

Funding is not the problem. The OCC receives no tax moneys and is funded entirely by user-fees. To carry out its mission, the OCC must be able to spend, from its own funds, the amounts necessary to respond to changing conditions in the banking industry. We should not be subject to arbitrary, across-the-board cuts in spending levels.

Thank you very much.

[The prepared statement of Mr. Clarke follows:]

FOR RELEASE UPON DELIVERY
JUNE 17, 1986 10:00 a.m.

STATEMENT OF
ROBERT L. CLARKE
COMPTROLLER OF THE CURRENCY
Before the
GENERAL OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE
of the
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
June 17, 1986

Introduction

Mr. Chairman and members of the Subcommittee, I welcome the opportunity to appear before you to discuss the effects of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings) on the Office of the Comptroller of the Currency (OCC) and its ability to supervise, examine and generally oversee the operations of the national banking system. As you posed in your invitation, these cuts are affecting OCC's ability to supervise effectively the national banking system. I will explain to you this morning why this is the case.

OCC and G-R-H's Effect on Independence

OCC was organized in 1863 as a self-supporting bureau of the Department of the Treasury under general supervision of the Secretary, charged with supervision and regulation of approximately 5,000 nationally chartered banks. It receives no appropriations and operates without any tax monies. The Office is funded entirely from assessments levied on national banks, application fees and investment income.

Congress has recognized how important a sound banking industry is to the well-being of the nation by its early actions and its repeated affirmations, and has attempted to endow the bank regulatory agencies with a measure of independence to protect their decision-making processes. The Comptroller's five-year term of office is an example of this Congressional intent.

Specific statutory grants of authority to the Comptroller, found in 12 U.S.C. §§ 481 and 482, authorize him to conduct bank examinations as often as he deems necessary and to determine amounts to be assessed and expended for bank examinations. The statute states that these monies "shall not be construed to be government funds or appropriated monies." Consequently, unspent OCC funds cannot be diverted to any other use. Therefore, application of G-R-H reductions to the OCC

threatens OCC's effectiveness as a bank regulator and will not result in any impact, whatsoever on the federal budget deficit and efforts to control it. The result is not only disturbing but anomalous since the Federal Reserve Board's supervision program is exempt from the Act.

The Comptroller's Office must have the necessary flexibility to set appropriate levels of supervision for the individual banks and for the industry as a whole. These levels are adjusted from time to time as economic conditions and conditions within the industry change. The quality and amount of supervision must be determined by the OCC's judgment about conditions in the industry.

Industry Conditions Warrant Greater Resources

Since the early 1980's, trends in the nation's financial system have made OCC's mission more challenging, demanding not only more but also more efficient use of available resources. Those trends include:

- o Increased pressures on the national banking system
- o Continued growth in the national banking system

Increased pressures on the national banking system

It is widely understood that the banking system is under

pressure. Last year, of the approximately 15,000 commercial banks, 118 banks failed, the most in any year since the Great Depression. Thirty of the 118 were national banks supervised by OCC. At least that many failures are expected in 1986. As of last Friday, 57 banks had failed of which 21 were supervised by OCC.

The pressures on the industry, however, extend beyond the number of bank failures. For the industry as a whole, profitability is declining. Although the majority of the banking industry continues to generate adequate earnings, there is a growing minority of commercial banks with earnings that can only be characterized as poor. For the 4,500 national banks with assets of less than \$300 million, the average return on assets has declined in each of the past six years. For the largest national banks, earnings have been flat over this period. The number of national banks with losses has risen dramatically. In 1980, 3 percent had losses; in 1985, 16 percent had losses.

These pressures have significantly increased the demands on OCC resources. The number of national banks receiving special supervisory attention has quadrupled since 1980. Currently, 21 percent of all national banks, with 25 percent of national bank assets, are receiving special supervisory attention. The resources needed to supervise the national banking system are greater now than at any time in the last 50 years.

Continued growth in the national banking system

The national banking system has grown both in number of banks and in assets. In 1979 there were 4,400 national banks, today there are approximately 5,000, and the number is still growing. In 1979 total national bank assets were \$996 billion, while at the end of 1985 they totaled \$1.6 trillion.

To meet the increased demands of supervision and regulation within the limits of available resources, OCC has pursued the strategy adopted in 1981 designed to utilize technology and innovative procedures for off-site monitoring of bank performance. As a result, resource intensive on-site examinations can be directed at the institutions that present the greatest risks to the safety and soundness of the entire banking system. As part of our 1986 supervisory plan, for instance, we decided to forego on-site examinations at 1,200 community national banks that had been identified through off-site analysis as posing the least risk to the banking system.

Despite OCC's best efforts, the OCC simply needs more examiners because of the increased number of banks and the overall condition of the national banking system. The need for additional examiners was recognized by the Treasury Department which requested 150 additional full-time equivalents for OCC in

FY 1987. That increase was proposed in the President's 1987 budget and demonstrates the Administration's commitment to addressing the problems.

Operational Effect of Gramm-Rudman-Hollings Reductions

The impact of the actual Gramm-Rudman-Hollings reductions in FY 1986 is two-fold. First, the reductions restrict expenditures for programs and projects necessary to fulfill OCC's supervisory strategy. This strategy was developed to allow OCC the flexibility to meet the continually increasing supervisory demands of a troubled industry through increased, less resource-intensive off-site analysis and minimize increases in staff.

Second, the 4.3% sequestration for FY 1986 has resulted in staff reductions below levels prudent to meet targets, in spite of our effort to reduce expenses without reducing personnel. In FY 1986, staff reductions due to Gramm-Rudman reductions will result from a hiring freeze combined with attrition. Depending on the magnitude of a possible 1987 sequestration, it could significantly affect our ability to hire new examiners, or, it could result in further staff reductions.

OCC's supervisory mission will be frustrated in the future as today's reduced or eliminated recruitment, hiring, and training restricts the number of trained examiners available in the future to fill commissioned examiner positions.

OCC's Supervisory Approach

OCC's supervisory approach encompasses all supervisory efforts, both on-site examinations and off-site analyses. It considers all aspects of banking, not just asset size and bank composite rating, in determining risk to the national banking system. This approach is dynamic and focuses on prospective condition, allocating our limited resources based upon a hierarchy of risk.

Current Resource Usage

OCC is a people-intensive organization primarily composed of examiners, 80% of which are involved in bank supervision. The majority of its costs, 88%, are either staff related, i.e., salaries and benefits, travel related to examinations and requisite training, or fixed, e.g., office space and equipment, telephone and postage. Other expenses arise from investments in projects required to fulfill OCC's supervisory strategies or programs designed to promote stable employment. Further sequestration could prove problematic.

OCC's investment in its employees is substantial. The bank examiner position is an apprentice occupation. It costs OCC more than \$30,000, exclusive of compensation, to train an examiner to become a commissioned National Bank Examiner by the fifth or sixth year of employment. Once trained, the examiners are in great demand by the financial industry. As a result, OCC experiences a substantial turnover rate, averaging about 14 percent over the past five years. Turnover is particularly acute in geographical areas where severe industry problems exist, such as the Midwestern and Southwestern Districts. Currently, we retain many of our employees by providing programs and incentives to produce an attractive career environment. Curtailment of these programs and incentives can be expected to result in higher turnover and the further loss of our experienced examiners.

Because of OCC's high turnover rate, we must keep up a steady process of recruitment and training. When that process is interrupted as it was this year by G-R-H, it becomes a problem for us several years in the future when the experienced examiners are in short supply.

A reduction in experienced examiners will increase current and future resource requirements of OCC because supervision procedures performed by less experienced examiners generally

require more time and, in addition, our experienced examiners will have to be diverted in order to train new employees. It will be difficult, if not impossible, to catch up.

OCC's supervisory strategy requires investment in both facilities and automation. Off-site supervision relies on bank financial data, generated from sources such as the bank call reports and analyzed through supervisory information systems, to determine the degree of bank stability and to pinpoint particular areas of weakness. On-site activity is then focused on these specific areas of concern.

Although off-site supervision reduces resource needs and travel costs, space must be provided for examiners to work (where previously they had performed most of their work in banks and needed no permanent offices), and information systems must be designed, implemented and maintained to provide the tools for their analytical efforts. Curtailment of facilities and automation will inhibit our future supervisory efforts or increase resource demands because we cannot achieve the efficiencies inherent in our off-site strategy.

FY 1986

Although OCC maintains that it should not be subject to Gramm-Rudman-Hollings, it has adopted a program to reduce

expenditures in FY 1986. This program was based on three tenets:

1. Maintain supervisory resources at the highest possible level;
2. minimize the impact on current employees to avoid an increase in turnover and the loss of experienced examiners; and
3. maintain minimal investment in programs that provide future cost savings or efficiencies in resource usage.

All projected expenditures were evaluated in the context of these guidelines. However, the G-R-H mandated reductions are so significant that only 60 percent of the reductions can be achieved by reducing non-personnel related expenditures.

To meet Gramm-Rudman-Hollings targets, OCC chose to reduce staff resources through the implementation of a hiring freeze and, potentially, through furloughs, the least harmful ways to achieve personnel cost savings. A recent analysis of the staff reduction which resulted from our hiring freeze indicates that:

- o The freeze will reduce the number of field examiners in bank supervision by 275 during FY 1986. This constitutes 12 percent of our field examining force. In Washington, the freeze will result in a reduction of 73 employees, or 11 percent of headquarters staff.
- o Approximately 700 community national banks, or 14 percent of the national banking system, will not receive planned on-site supervision in 1986.
- o Of these 700, over 100 are community banks that have been identified as likely to suffer a deterioration in their financial condition will not receive planned on-site supervision in 1986.

Note that the 700 community banks are in addition to the 1,200 community banks not planned for on-site supervision in 1986. The on-site supervision program for community banks has been curtailed to direct our limited resources to areas of higher risk.

Conclusion

The Gramm-Rudman-Hollings reductions for FY 1986 are currently hindering the OCC's efforts to achieve fully our supervisory mandate at a time when the banking system is subject to

significant pressures. Although the 1986 cuts are manageable, future cuts, if required, will severely impair our ability to supervise national banks. Accordingly, the Administration favors Congress reconsidering the applicability of Gramm-Rudman-Hollings to the bank regulators for 1987 and beyond.

Congress has always taken very special care to insulate the bank regulators from forces that run contrary to our primary mission of fostering the safety and soundness of the national banking system.

Funding is not the problem. OCC receives no tax monies and is funded entirely by user-fees. To carry out its mission, the OCC must be able to spend, from its own funds, the amounts necessary to respond to changing conditions in the banking industry. We should not be subject to arbitrary, across-the-board cuts in spending levels.

Chairman HUBBARD. Thank you very much, Bob Clarke, and each of you.

We now will ask you to try to answer our questions.

First, yesterday, we were all interested to read in The Washington Post that the Supreme Court was to have ruled yesterday by a vote of 7 to 2 to strike down the key automatic triggering provision of the Gramm-Rudman-Hollings Act; however, the Supreme Court, in their wisdom, said nothing yesterday about Gramm-Rudman-Hollings, and so the historic decision was not announced yesterday.

My question is this: Assuming that such a decision is forthcoming, assuming there is a leak over there at the Supreme Court, which is unfortunate, understanding the fallback provision of Gramm-Rudman-Hollings still allows the Office of Management and Budget and the Congressional Budget Office to continue to calculate the cuts and requires approval by the President and the Congress, do each of you believe there will still be as much concern about Gramm-Rudman-Hollings and its effects upon your agencies, if indeed, the media is correct that soon we are going to have a 7 to 2 decision by the Supreme Court declaring unconstitutional that portion of the law which would allow the Comptroller General of the GAO to cut back on the spending or to require the spending cuts?

In other words, if the automatic cuts provision is nullified, is there still some worry at the FDIC, the Federal Home Loan Bank Board and the Comptroller's Office?

Mr. SEIDMAN. Well, Mr. Chairman, I would, of course, be concerned, because the Congress can still act to reaffirm the cuts of Gramm-Rudman-Hollings, and I would hope at that point, they would take into consideration some unintended effects, of which I think the three of us here are an example. I don't believe that in enacting that, the particular problems of these self-financed agencies, where cuts merely mean that we either return funds to the people who are paying us for our services or put money—more money into a trust fund, which is not available to deal with the deficit, were considered at the time the bill was passed.

So I would hope that if there is another up or down vote on that part, it could be an amendment of the act to exclude those agencies which I don't believe were intended to be included.

Chairman HUBBARD. Very well said, and members of this subcommittee are listening to your comments as to the need for that type amendment, as we further take up Gramm-Rudman-Hollings later in this Congress.

Mr. GRAY. Mr. Chairman.

Chairman HUBBARD. Mr. Gray.

Mr. GRAY. I am not sure I understand exactly what happens if the Court, for example, theoretically were to nullify the current authority that is vested in the Comptroller at the GAO. But I believe there is another mechanism by which perhaps the same effect could be achieved. I would hope that whatever mechanism might be used would take into account the kinds of things that I believe all three of us in our respective capacities have brought before you today, and in effect, handle it in that matter, if the Congress chooses not to take us out completely.

Chairman HUBBARD. Mr. Clarke, do you care to add to that?

Mr. CLARKE. Mr. Chairman, I agree with Chairman Gray. I am not certain exactly what mechanism would be used to continue to include us under the act, but it is my understanding that there is a mechanism by which that can be done, and then it would still be necessary for Congress to act to give us some relief.

Chairman HUBBARD. For those of us who represent rural areas, these cutbacks—how would they affect the small institutions, such as those found in my own 24-county congressional district which has no large financial institutions, but many, many small ones? In your supervisory efforts, does the size of an institution determine in any way the degree of attention it receives?

Mr. GRAY. Mr. Chairman, let me answer your question this way. I don't think the size necessarily governs what kind of action we are going to take. But I would like to point out to the subcommittee that last July, all of the examiners which formerly were under civil service in Washington and reported directly to the Federal Home Loan Bank Board were transferred from Civil Service to the Federal home loan bank districts. The Federal home loan banks themselves are not subject to Gramm-Rudman, although the Federal home loan banks in all of their operations report to the Bank Board, and the Bank Board exercises full oversight over these banks.

So in our case, none of the examination and supervision of our insured institutions is under Gramm-Rudman-Hollings.

Now on the other hand, the support from the legal side, the policy development side, the analysis side, and all the other operations of the Federal Home Loan Bank Board in Washington, are, in fact, under Gramm-Rudman-Hollings. So to that extent, we are affected. And I am very concerned, as I expressed in my statement. But I think in the case of both of these gentlemen, they do not have Federal home loan bank districts from which they can transfer. I am delighted. It was an accident, possibly, of history or good luck, maybe good planning, that we actually exercised that transfer on July 7th of last year, not knowing that the Congress would ultimately come up with Gramm-Rudman-Hollings.

Mr. SEIDMAN. With regard to the size of banks, why, we don't make that a standard for judgment. I would have to say that, in fact, we look at the threat to the insurance fund.

And since larger banks tend to be a larger threat as resources get scarcer, I wouldn't be surprised if an indepth study would show that more rural banks were omitted from examination than some of the bigger ones.

Chairman HUBBARD. You could add to that, Mr. Clarke?

Mr. CLARKE. Just to emphasize the data that I included in my statement, that we decided earlier, based on our offsite analysis, to forgo onsite visits to 1,200 community banks. But, because of the Gramm-Rudman-Hollings cutbacks, we have had to eliminate onsite visits to another 700 community banks.

Chairman HUBBARD. Thank you. I have several questions to each of you individually. However, in fairness to my colleagues, I want to move right on to give them a chance. And I will be the last one to ask these questions, if they are not asked by my colleagues.

First, Congressman Stan Parris, our ranking minority member from Virginia.

Mr. PARRIS. Thank you, Mr. Chairman.

Let me first ask unanimous consent that my opening statement appear in the record of the hearing this morning immediately after your statement, if I might.

Chairman HUBBARD. Without objection, that is ordered.

Mr. PARRIS. Second, I just have a couple of very quick questions, gentlemen.

It seems to me that some of these issues that we are wrestling with this morning, as I have said before, involve the use of what are, to me, arcane laws in a bureaucratic turf battle. And the question really is: How did we get you under Gramm-Rudman to start with?

Well, as one member of this subcommittee and the Congress, I did not support what I think is the excessively inflexible provisions of Gramm-Rudman in the first place.

But, even more importantly than that, I am finding very compelling your argument, that I think each of you gentlemen made in one way or another, that your particular agency should be exempted from that in terms of the use of your funds because all of the assessments in the industry and the institutions that you regulate come from the industry—not from the taxpayer.

So the exemption certainly would seem to me to be self-evident, that it's warranted. Not \$1 of budget savings that you achieve will have any effect on the deficit in the first place, and simply put, the use of your funds is not Federal expenditure.

Now, how do you get the OMB involved in the use of non-Federal expenditures by the extension of some tortuous reasoning?

It seems to me a little ludicrous that we are here at all. But, reality, as you know, is that we are, and you are. And you are apparently by some edict already impacted, and the question is do you remain such.

I am also a cosponsor of the so-called Carper bill, the Examination Improvement Act. And my first question is do you, Ed, made specific mention that you support that bill as filed, as pending. I don't mean to suggest it's perfect, but—

Mr. GRAY. Right.

Mr. PARRIS. But, you are in favor of the bill and adoption at its earliest date, I suppose?

Mr. GRAY. Yes. I think I am. And I believe—my colleagues per se can speak for themselves. But I suppose the one difficulty I have with the bill is that we won the flexibility by unilaterally moving our examiners out. We have increased the number of examiners from 750 to 1,250 in just 1 year. We will be at 1,500 by the end of this year.

They have hiring freezes, moratoriums. We are increasing from 750 to 1,500 in a year and a half, which is what we need. And so anything that the Carper bill would do to take away from the flexibility that we enjoy now because of the action that we took, I would have concerns about. But, yes, of course I am for the thrust of that bill. Absolutely.

Mr. PARRIS. Do you other gentlemen take that same position?

Mr. SEIDMAN. Yes, I testified we are very much in favor of the bill. We have a few suggestions, but we are very much in favor of the bill and support it fully.

Mr. PARRIS. Are there any fundamental amendments that you think the bill requires in order to make it workable?

I don't mean it can't be improved, but is there something fundamentally flawed that simply has to be changed in the bill?

Mr. SEIDMAN. We found no fundamental flaw from our point of view.

Mr. GRAY. The one thing we ought to keep in mind is the necessity of maintaining the flexibility that we have gained. Anything that would take away our flexibility, we should be careful of.

Mr. PARRIS. Mr. Clarke, would you have anything to add to that?

Mr. CLARKE. Only to cite that, in addition to dealing with the Gramm-Rudman-Hollings problem, the bill addresses what I think is a very important issue—the compensation of bank supervisory personnel to enable us to attract and retain qualified examiners. We very much appreciate the subcommittee's interest and support with regard to that issue.

Mr. PARRIS. I certainly agree with that observation, Mr. Clarke. I think, very honestly, we are ignoring the pressing priorities. And that leads me into my second question, and it's addressed basically to Mr. Seidman.

Some of us anticipate, Bill, that when the second quarter reports to your organization, the FDIC, come out in late July, I gather, that there is some reason to anticipate that they will not be exactly a rosy scenario.

Now I don't mean to be the prophet of doom, or whatever. But, as Mr. Clarke testified on page 4 of his prepared statement, he makes the point that profitability in the industry as a whole is declining, and goes on to say that the need is greater now to supervise than has been true at any time in the last 50 years.

Now that's strong statements, from a gentleman that is obviously in the thick of the fight.

My question is: If there is some apprehension about the near-term results of the reporting of the industry situation, do you expect that you are going to need more, not less, in the way of personnel and assistance and supervision?

Is that not a fair assumption?

Mr. SEIDMAN. We will. I have indicated in my testimony that within the next year from now, we will need something in the order of 500 more examiners to meet the increasing number of problem banks that we have to deal with.

I testified that our problem banks are over 1,300. They are well over 1,300 and still moving up. And, therefore, the need to supervise in order to hold down the cost to the insurance fund and maintain the stability in the system is increasing.

Mr. PARRIS. Mr. Clarke specifically stated, in your testimony, that you anticipate the need for additional personnel. I recall that in your testimony.

Mr. CLARKE. Yes, sir; we had received approval for an additional 150 full-time equivalent employees for fiscal year 1987. Of course, we have not been able to move toward bringing those people on board. In fact, we will be down an additional 275 field examiners this year as a result of the Gramm-Rudman cuts.

I don't want to sound like a broken record, but it's not just the number of people. It is the experience level of the people. When we

put employees through a 5-year training program and they become commissioned national bank examiners, they are a valuable commodity to the industry. We need to do something to try to stem the turnover because when we lose one of those people, we have no choice but to go back and start the cycle over again and spend 5 more years training somebody else.

Mr. PARRIS. Well, I have the strong feeling you are just not competitive, Mr. Clarke, as you know. One, because of the limitations. Not self-imposed, I might add.

Just one last question, Mr. Chairman. I will be brief with it.

Mr. Seidman, in 1981, you conducted 6,383 examinations and there were 223 problem institutions. In 1985, the number of examinations dropped dramatically, to about half or thereabouts, of those the year before, but there was a dramatic increase on the number of problem institutions in 1985 to 1,140, an increase of 700 percent, roughly.

Now, there are a number of factors in all of that. I understand that. But, using 100 percent as the level of that, could you give us a guess? Is there any way to quantify what percentage of those 1,140 problem institutions could be attributable to reduced bank examinations?

Mr. SEIDMAN. I guess I wouldn't know how that you could actually get a number on that. But, clearly, what has happened to us is that we have had to concentrate our resources on problem institutions, as a result of which, we have had to do much less with compliance, with consumer laws and money laundering and other types of things. And we have simply not been able to maintain the standards which we set for ourselves. As a result of that, we do get more problem institutions because we don't find them until later in the cycle.

Mr. PARRIS. But it's not reasonable to conclude, is it, Mr. Seidman, that they were always out there, you just didn't find them when you are doing one-half of the examinations you were doing before? I mean, that just doesn't—

Mr. SEIDMAN. No, I think the basic conditions in the banking industry have clearly changed. Deregulation and economic conditions have both worked to give us a far larger number of problem banks.

Mr. PARRIS. Thank you, Mr. Chairman. You have been very generous. Thank you.

Chairman HUBBARD. Thank you, Congressman Parris.

Forty members of our Banking Committee, incidentally, cosponsored H.R. 4917, including all of the members present at this hearing, were cosponsors of that legislation to improve the quality of examinations of depository institutions, and for other purposes.

Congressman Kanjorski.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Not to continue the dance, gentlemen. I will probably play the role of the devil's advocate.

Mr. Seidman, in your testimony, you indicated that, as I understand it, you like the spirit of Gramm-Rudman. You just don't like how it applies to your agency; and I can sympathize with that.

But I would like Mr. Gray and Mr. Clarke, do you two gentlemen also agree with Gramm-Rudman as it's constructed, in spirit, but

the only reason you disagree is because it applies to your particular agency?

Mr. GRAY. Well, in my case, I would not want to second-guess the wisdom of Congress at this table. The Congress chose to pass that law. I think it is impertinent for me to comment on anything other than how this affects my agency.

Mr. KANJORSKI. Mr. Gray, that's the point. Everybody in this country thinks it's impertinent to share their wisdom with the Representatives of the people, and I think that's maybe why we have Gramm-Rudman.

I mean, we obviously have other solutions to the deficit problem, but now we have a monster that the Congress has created on the books, perhaps with the insight the gentlemen, yourselves, in the financial field could have given the Congress we might not have made such a mistake if you had just spoken out.

Well, I don't know that it's fair for you to come up here and speak out only for your interests to be exempted, because if you are exempted, true, it may not affect the direct revenues to the Government, but think of it this way:

If we keep you in Gramm-Rudman, the money that you are going to save—and I agree with you, you are not going to save anything. You are going to cost us, just the money—but that money in the immediate, short range would be saved, will allow these institutions that you inspect to be taxed perhaps greater, or to distribute their funds to their shareholders, who would pay a higher tax.

So that, ultimately, there will be a return in the system of that money if we keep you under Gramm-Rudman.

Mr. GRAY. Well, I disagree. I think that what will happen is there will not be enough examination and supervisory capabilities to prevent unnecessary losses.

Back in 1983 and 1984, we were pleading for additional examiners and—

Mr. KANJORSKI. But, Mr. Gray—

Mr. GRAY. And we didn't get them. And look at the problems we have right now.

Mr. KANJORSKI. Isn't that happening with the IRS, with the decrease in audits and the reduction in the collection?

Isn't that going to occur to the FAA when we have multi-air collisions as a result of the lack of controllers and control we have in the air?

Isn't that going to happen to the Pentagon lost in Government contracts when we don't have enough auditors, or auditors are removed on light item savings so that they can't audit the defense fraud that occurs?

Isn't the application of this act across the board going to be very expensive to most regulatory or controlling agencies?

Mr. GRAY. Well, I am not trying to evade your question. I am not, in all honesty not that familiar with other agencies. And I suppose that could be true.

I think the Congress had a very difficult time dealing with the deficit. I guess the Congress decided the only way to do it, to discipline itself, was to do it in this rigid manner, which is called Gramm-Rudman.

But I suppose the fact that the Congress recognized the importance of dealing with the deficit is very important, and was very important. How they did it is another matter.

Mr. KANJORSKI. Well, I mean, ultimately, there were other solutions.

Mr. GRAY. That is right.

Mr. KANJORSKI. I guess what I am asking you is: Suppose the Supreme Court rules the automatic sequestration is unconstitutional, and it has to go back to the decision of the Congress? I thought I heard you gentlemen asking that, in some way, we exempt your agencies at that point.

The fallback positions in Gramm-Rudman won't allow us to offer amendments. It will be an up-and-down vote.

Mr. GRAY. I think that public confidence in our financial system is great enough so that the Congress ought to take another look at this and reexamine it because the consequences could be far greater than any of us would like.

Mr. KANJORSKI. I agree with that proposition.

Let me go one step further and ask you this. You know, we talk about the deficit reduction. But when are we going to get gentlemen of your caliber to stand up and talk about the fact that we had a 25-percent cut in taxes and that we have an administration that talks about how we can balance this budget or bring it into balance by cutting domestic programs, and that we don't have anybody of your caliber challenging this theory when we look at what we would have to cut—two-thirds of all Government operations across the board in order to have that, in reality, occur.

If we can't get the benefit of the thinking of men of leadership such as yourself, where are we to get this input?

The Congress can't—I, myself, will plead that I am much more inadequate than you in giving advice on the subject.

Mr. GRAY. Well, I am not sure that you should take my advice. I am just a citizen and a regulator and I don't make laws. Congress is elected to make laws and deal with these problems. I am chosen to regulate the savings and loan industry.

But, clearly, there is a deficit and the Congress chose this means to face it. Either you have to raise taxes or reduce expenses.

Mr. KANJORSKI. Can we reduce expenses in this country sufficiently to balance this budget and still carry on the mission and the responsibility of Government that we have?

Can you answer that question?

Mr. GRAY. Well, if it is done, and the Congress chooses to do it, I think that it will not be done by sequestering funds from agencies like ours, where we don't take money from the taxpayers in any event.

Mr. KANJORSKI. Should we take that from the national defense? Are they able to afford it more?

Mr. GRAY. You know, I am a regulator of savings and loans. This is a big public debate which is before the American people. The American people will sit there in oversight. And then, when elections come, they will make the decision.

Mr. KANJORSKI. I agree with you. And I guess what I am trying to do, Chairman Gray, is find some vehicle that has the American people understand that the monster that we created, what it is.

And it was interesting to hear all three of you gentlemen talk about how laborious it was to conform with the 4.3-percent cuts. As a Member of Congress, I found it difficult. I had to reduce my staff by three people to do it.

I look at the next sequestration order and see no possibility to provide the services necessary for my office. So I sympathize with your problem.

But I guess what I am trying to do is exact from responsible executives such as yourselves a role of leadership beyond your regulatory agency role. Someone has got to start speaking out to the American people about the overall concept of Gramm-Rudman and that it is not feasible to implement, and that it really is a facade of the worst political types that could be carried out, because we have said we have acted responsibly to balance the budget, now we can go home. And we all know that is not true.

But, it is important. And I do thank you for testifying before us today to call to the attention of this subcommittee, to the Congress and to the American people the fact that what these unreasonable cuts will mean in just the independent regulatory agencies.

I would like to expand that to what it will mean to the FAA and many of our other areas. And when we start having air collisions and other problems that we ultimately have, maybe the wise men will revisit this act.

Thank you.

Chairman HUBBARD. Congressman Al McCandless, California.

Mr. McCANDLESS. Thank you, Mr. Chairman.

I find these editorials very interesting about Gramm-Rudman. I thought we were here to discuss more the issue that the three gentlemen represent.

I can't help but add to the editorials a little bit, if I may.

Back in 1978, there was a proposition—called 13—on the ballot that passed in California, which could be easily classified as the California version of the Gramm-Rudman.

At that time, everyone in public government of some type or another said that California would fall off into the sea if this passed. It's interesting how California is still there and better off for it because it forced those who were in governmental positions to think a little longer, to perform a little better, and to come up with more innovative ideas on how to accomplish the same purpose.

Now that I have finished my editorial, to add to the others, I would like to get back to the issue at hand here and discuss with our three panel members the areas of my interest.

Just to review for my information, it is my understanding that in the case of the three areas in question, the Comptroller of the Currency, FDIC, and FSLIC, these are by and large self-supporting institutions as far as the examination/audit process is concerned.

Do I understand correctly?

Mr. SEIDMAN. Yes, sir.

Mr. GRAY. Yes.

Mr. McCANDLESS. Does that include the administration expenses of these auditors and examinations also?

Mr. SEIDMAN. Yes.

Mr. GRAY. Yes.

Mr. CLARKE. Yes, sir.

Mr. McCANDLESS. And this amount of money is established by an assessment to the institutions involved; is that correct?

Mr. CLARKE. Yes.

Mr. SEIDMAN. Yes.

Mr. GRAY. And by fees.

Mr. McCANDLESS. Fees, yes. So that the level of funding required to carry out a given task, whether it be x number of people or Y number of people, is established through an administrative procedure in conjunction with an assessment of the organizations in question?

Mr. SEIDMAN. The assessment is set by the Congress.

Mr. GRAY. Or fees.

Mr. McCANDLESS. So we have then—

Mr. GRAY. But there's a limit on the assessment.

Mr. McCANDLESS. Just for the record, how is the assessment established? Let's say that we need an additional amount of money because of—whatever.

How is that assessment established? Is it established administratively within the executive branch, or is it established by some type of a council of members of the organization?

How do we establish an increase in fees if that is deemed to be necessary?

Mr. SEIDMAN. Well, if we were to want to increase fees, we would have to get congressional action because we have an assessment of one-twelfth to 1 percent of deposits, which was set.

Mr. McCANDLESS. Does the growth of the institutions take up what is necessary in the way of slack?

Mr. SEIDMAN. It has so far, although we have been in past years rebating, as we do if we don't use all the assessment in operations in taking care of losses. We rebate 60 percent of that assessment back to the banks, and 40 percent of what we have left goes into the trust fund to take care of future losses.

So, up until recently, we have always paid rebates. In the last year, we used up the entire amount of the assessment in operations and losses. And, therefore, for the first time, I think, since the fund was established, or right after the Great Depression, we had no rebate.

Mr. GRAY. We have two sources of funds. One is from the Federal home loan banks. All of our member institutions must buy stock as prescribed by law in the Federal home loan banks. And also all of our insured institutions must pay premiums of one-twelfth of 1 percent on the anniversary date of the institution. We also have additional authority to assess at what we call a special assessment, which is as much as one-eighth of 1 percent above the one-twelfth of 1 percent.

And we are exercising that to the fullest because of the necessity to do so today.

And then, yes, one of the things that I should mention is that, for the most part, the cost of examinations is paid for by the institution through the fees that are paid for examinations.

But the ultimate source of funds is the FSLIC and the Federal home loan banks, and the entire operation of the Bank Board is

funded basically by about one-quarter from the Federal home loan banks, and three-quarters from the FSLIC.

Mr. McCANDLESS. Mr. Clarke, could you share with us how your fees are assessed and how they are arrived at?

Mr. CLARKE. Yes, sir. We also have two primary sources of income. One is fees, such as filing fees for charter applications, merger applications and the like, which are set to approximate our costs in processing those applications. The second is assessments, which are based on asset size, figured on an annual basis, and paid twice a year by the banks. We can adjust the assessments from year to year based on our anticipated expenditure needs. We also maintain a reserve so that if we should have an inordinate expenditure during the course of a year, such as having to send a large number of examiners to a particular area of the country, we could respond without having to raise additional money.

Mr. McCANDLESS. The bill in question here, or discussion, previously alluded to as H.R. 4917, which started out as H.R. 3567, I understand from previous testimony that the three of you are in general in favor of the contents of that bill, or the direction.

Mr. GRAY. Is that the Carper bill?

Mr. McCANDLESS. Well, I got myself squared away here. Mr. Miller's letter to our chairman referred to it as H.R. 3567. The actual copy of the bill, of which I am a cosponsor, is titled H.R. 4917. And I am told by staff that the number was changed somewhere along the line.

Am I correct, or have I been misinformed?

Mr. GRAY. Yes, that is the Carper-Lundine bill.

Mr. McCANDLESS. Incidentally, before I move on to the rest of the area I want to cover, I am certainly a supporter of the fee system for a service rendered. That concept is something that works very well in government at lower levels and provides the necessary resources to provide that service to a segment of what is required in the way of oversight by some level of government, be it planning of land use or whatever else.

Fees are, in my opinion, what are necessary. So, philosophically, I am aligned with your position.

The other question I have deals with the ability of the three institutions here to deal with State-chartered banks, State-chartered savings and loans, wherein the State has its own examiners. And those examiners certainly, in most cases, would appear to me adequately trained or adequate in their job, that there doesn't need to be necessarily that duplication of effort.

In the bill in question here, we deal with that in a certain way by—and I will paraphrase it:

It establishes minimum requirements for examinations of depository institutions.

And it goes on to say that the State supervisors, in order for such examinations, that they be adequate for purposes of Federal law.

So it becomes then the Federal overseer to determine whether or not those examinations are acceptable in lieu of a Federal examination.

Are you in support of that as far as the bill is concerned?

Mr. SEIDMAN. I think that applies a great deal to our agency, since our primary interest is State, nonmember banks. We current-

ly have agreements with 30 some States for joint examination and cooperative examinations.

And in those agreements, we try to evaluate on a less formal basis each State's activity and accord them an appropriate position depending on that evaluation.

And we think that is working reasonably well, although it certainly can be improved. I think there might be some resentment on the State's part if they felt that the Federal agency was giving them an official evaluation.

At least, we have had some feeling from some States that they don't want to be evaluated by a Federal agency. But, in general, the thrust of the bill in that area, we believe in our agency is sound.

Mr. GRAY. Congressman, we of course examine both State-chartered and federally chartered institutions. We examine our own federally chartered institutions for insurance purposes and for compliance with Federal law. We examine State-chartered institutions for insurance purposes, and other Federal law that pertains to those institutions.

In my own view, I believe that the current system ought to continue, but I do think, for insurance purposes, that we ought to examine those institutions, shoulder to shoulder with examiners that the States provide.

Mr. McCANDLESS. Do you have anything to add?

Mr. CLARKE. We, as you know, do not examine or supervise State banks, so we do not have as much involvement as the other two agencies. But, wearing my FDIC Director's hat, I would certainly agree with what Chairman Seidman said about the necessity for continuing Federal involvement with those State supervisors.

You touched on the issue of whether the States are doing an adequate job of supervising their institutions. I think some are doing a good job and some aren't. Some have the very same problem that we have discussed this morning—an inability to compensate their examiners adequately so as to attract and retain good staffs. And I know some of the States are very interested in changing from an appropriated system to a system which is funded by the industry, as is the case for our three agencies.

Mr. McCANDLESS. It has been alluded to and I would like to bring it out. There are two other problems that have been brought to my attention that led up to the examination process prior to the fiscal aspect of it.

And that is the inability to hold experienced people for the salary ranges that were offered due to the private sector's attraction. And that's not unusual with district attorneys, or somebody like that, at lower levels again.

And also the fact that there appears to be some duplication based upon one of the sections of this bill on the types of schools and the training that the independent agencies give their proposed candidates who have been recruited.

And so, in the bill, we are talking about the consolidating of examiners training in one school.

Would you comment on that? Are you in favor of that? Is that a problem? If it's a problem, I would like to hear about it. If it isn't a problem, why hasn't it been done before?

Mr. GRAY. Well, I happen to be Chairman of the Federal Financial Institutions Examination Council. And both of these gentlemen are members of that council.

We do have common schools. And as a threshold matter, I think that common courses in matters which have the common denominator that goes across all these institutions is important.

I think, in the case of examining thrift institutions, which are so highly involved in real estate, that the kinds of training provided in the Federal Home Loan Bank System are particularly appropriate.

For example, even before we transferred the examiners out from civil service to the Federal home loan bank districts, we had established a training center in Dallas and we hired the Dean of the Business School of Southern Methodist University, Dr. Gene Burn. We have quite a staff there now.

As I indicated before, the numbers of our examiners are increasing tremendously, and are under the training guidance of that operation.

But the Exam Council does have courses. And we coordinate them. I think we ought to have our own operations in our own systems, but to the extent that there can be a melding and we can receive advantages, we should take advantage of that.

For example, we are talking now about a course for examiners on futures and options trading, which would be available across the board at the Exam Council.

That is a common denominator between banks and savings institutions. Those kinds of things would be very helpful.

Mr. McCANDLESS. I would like to conclude, Mr. Chairman. I have a problem here with our executive branch. In the concluding paragraph of Mr. Miller's letter of June 3, to Chairman St Germain, he says:

In my view, each agency of the executive branch, whatever its mission, constituency and however funded, must be fully accountable to elected Representatives of the American taxpayers, the President and Congress. To do otherwise, to enact this legislation, for example, would seriously impair that accountability and unwisely interfere with the President's authority to manage the executive branch. For these reasons, OMB strongly opposes this legislation.

Where are we interfering with these areas?

We seem to have a difference of opinion here about the value of the bill in question. That certainly is a step, in my opinion, in the right direction.

Yet, one of the key members of the team is saying: No, this is not the answer.

Mr. GRAY. Well, Congressman, from my point of view, the General Accounting Office oversees the operations of the Federal Home Loan Bank system.

Last year, I believe I appeared in 26 hearings before congressional committees. There are continuous requests for all kinds of oversight information from the various congressional committees. Our agency seeks, to the extent it is able, to be as responsive as humanly possible.

I believe the responsiveness to the American people through its elected Representatives does in fact exist in your oversight of our agency.

Mr. McCANDLESS. Do you have any comments, Mr. Seidman?

Mr. SEIDMAN. That paragraph appears to me to take the position that there is no such thing as an agency which is responsible to Congress and not to the executive branch.

And that is a point of view which many people argue should be the way the Government should be run.

I think that's a very fundamental question, and that is not the way it has been run. I think it's a very fundamental question, which, if OMB wishes to take the position that that is the way that operations should go, then they should step up and ask the Congress to pass a law which says that they have this power over every agency, including the Federal Reserve—which would be covered by that language—and then we'll all know that's the will of the people.

What I am concerned about is to see them dig back to 1950 for a statute to try to assert that kind of authority.

Mr. PARRIS. Would the gentleman yield?

Mr. McCANDLESS. Yes, Mr. Parris.

Mr. PARRIS. I appreciate that.

I did not have an opportunity to do it, but I included in my opening statement the remark of a famous description by Senator Fulbright that I think applies to this situation. He says: "OMB has the power to do any damn fool thing it wants to do and seems to do it about every 10 minutes." [Laughter.]

Mr. McCANDLESS. Do you want to comment on that, Mr. Clarke?

Mr. CLARKE. Only on the issue of oversight. I don't think any of us would take the position that we should be totally independent of anybody looking over our shoulder. In our case, as a bureau of the Treasury Department, we are subject to Treasury's oversight, for example, submitting our budget to them for approval.

We certainly are subject to oversight by the Congress, witness the fact that we are here this morning. We also have an audit done by an independent auditing firm which is made available publicly as soon as it is completed. So, in my judgment, there is plenty of oversight taking place today.

Mr. McCANDLESS. I would like to thank all three of you for coming before us. It has been very enlightening and very informative.

I thank the chairman for calling this hearing.

Chairman HUBBARD. We should be able to finish at noon or shortly thereafter. No doubt one of our good colleagues will have a burning desire for a vote on approval of the journal, one of those times we contribute so much as we go take about 30 minutes for a vote. [Laughter.]

But I do have some questions which I postponed in order to give my colleagues on the subcommittee a chance to ask theirs.

Mr. Clarke, absent from your testimony was any reference to the Anti-Deficiency Act.

Would you discuss how the apportionment provisions of that act now affect the Office of the Comptroller of the Currency and how they will affect your agency in the future?

Also, if you will, what problems does the Anti-Deficiency Act pose and do you believe the regulators should be exempt from this Anti-Deficiency Act?

Mr. CLARKE. The answer to the last question is yes. I do believe the regulators should be exempt.

Chairman HUBBARD. OK. Do you want me to repeat the other questions, or do you remember them?

The first one was how will they affect your agency in the future, and the second one, what problems does the Anti-Deficiency Act pose for your agency?

Mr. CLARKE. We have not been previously subjected to the Anti-Deficiency Act, Mr. Chairman. As you know, the Anti-Deficiency Act was enacted by the Congress to deal with agencies that receive appropriated funds. We do not, as I said earlier, have any appropriated funds. The purpose of the act, as I understand it, is to keep agencies that do have appropriated funds from spending all of their appropriated funds in the first part of the year and then coming back to the Congress for supplemental appropriations. Since we don't have appropriated funds, it seems to me that it is not appropriate for us to be included under an act that was designed to deal with appropriated agencies. We have taken that legal position and are sticking by that legal position.

The effect that apportionment would have on an organization such as the Comptroller's Office is simply establishing an additional organization that has control over our budget and the manner in which we spend our money. As I indicated earlier, it seems to me that there is sufficient oversight taking place today and that the number of additional people making judgments about where we need to be devoting our resources, which banks we need to be examining, how many charters we need to be granting, that sort of thing, all of which can get into political considerations, should be minimized.

I simply don't think that the Anti-Deficiency Act needs to be applied to us.

Chairman HUBBARD. I would ask this to Mr. Gray, but all three could answer as to your own agency's reaction to this 4.3-percent cut imposed by Gramm-Rudman-Hollings for fiscal year 1986.

How did you comply with this cut, and were there any staff reductions such as Congressman Kanjorski mentioned he had to do?

Mr. GRAY. We have taken care of that by reducing travel, which otherwise we believe is necessary given the nationwide nature of our system. We have had to cut some training. We have curtailed some contracts for special research and studies that we need on the effects of regulation on our industry, risk taking on our industry, and the impact of laws and regulations and taxes on the health of the industry.

Chairman HUBBARD. Were there staff reductions?

Mr. GRAY. I don't believe there were staff reductions. I believe this occurred because of what we did last year to transfer examiners out from Civil Service. Obviously, if this were to continue, it would affect staff. No question about it.

Chairman HUBBARD. Given the fact that come October 1 in the new fiscal year we are going to have additional cuts unless Gramm-Rudman-Hollings is repealed, this will further limit your agency, I assume?

Mr. GRAY. Yes, it will.

Chairman HUBBARD. What about Mr. Seidman and the FDIC?

Mr. GRAY. I think it will hurt our agency very seriously. I don't want to understate the effects it will have. The support functions for protecting the FSLIC that don't necessarily go directly to examination and supervision but the legal support that you get, policy support, other support functions at the bank board that our professional staff provide.

Chairman HUBBARD. These contracts you referred to, were they over and above your own staff's performance? I assume this would be outside assistance that you cut out? You said you had eliminated some needed contractual work?

Mr. GRAY. Right, that and some travel which otherwise I believe would have been needed.

The kinds of studies that really we depend on, you know, the Federal Reserve has a lot of studies, all of our agencies have studies on the impact of various external things that are happening or could happen to the health of the industry.

Chairman HUBBARD. Mr. Seidman.

Mr. SEIDMAN. I have supplied to the subcommittee in my more detailed statement table 1, with a chart which gives you the reductions that we made.

Fundamentally, we froze all hiring except for examiners, and the other savings were in outside services, travel, building leased space, equipment, supplies, and expenses, other expenses, and we were able to do the one thing that we wanted to do, which was not to freeze hiring in the examination classification. But we have many open positions now which we have not filled because of the hiring freeze.

Chairman HUBBARD. On page 5, you refer to your field examiner force as being almost exactly the same as it was 5 years ago. Since 1981, the number of problem banks, however, has increased six times. You made national news last week by estimating that there may be as many as 150 banks to fail across America in 1986. Are we possibly already seeing the effects of insufficient or inadequate supervision over these banks?

Mr. SEIDMAN. Well, I would hope not, but it is certainly true that our resources are strained trying to keep up with the increases that we are seeing in the banking system.

Chairman HUBBARD. I am not trying to put words in your mouth, but would increased supervisory efforts in terms of more examiners and examinations help in your efforts to control the rise in the incidence of problem banks?

Mr. SEIDMAN. I think there is no question that increased supervision will help to hold down the number of banks that fail.

Chairman HUBBARD. Do you foresee a much greater risk to the insurance funds if the agencies are not exempted from Gramm-Rudman-Hollings?

Mr. SEIDMAN. I think there is a great risk, both on the supervision side and in the flexibility to handle a bank when it fails. Most of our decisionmaking is done within a 24-hour period in order to be able to handle a bank, stop any feeling of insecurity in the system, and assure that depositors get their money, and that requires a very flexible and fast-moving system.

Almost every transaction requires some special nuance. They are all somewhat different. Sometimes there are as many as three or

four at one time, and our board is meeting on Saturdays and Sundays and at night and during the day because you have to maintain that flexibility in order to retain the confidence in the system.

That is why I think adding another layer of supervision, and one that frankly I don't think brings much expertise to the table, is not going to be helpful to the system.

Chairman HUBBARD. And that layer you are referring to is?

Mr. SEIDMAN. Is the Anti-Deficiency Act.

Chairman HUBBARD. Right.

Mr. SEIDMAN. The Anti-Deficiency Act.

Because in our case, since we don't have appropriated funds either, OMB takes the position, I understand, or at least they have taken with us, that they set both the size and the apportionment, and their view is that they can't apportion unless they set the size of the budget.

So in this case we would be an agency where Congress has nothing to do with appropriating, and they are applying—so they set both the limits of spending and how you spend it.

Chairman HUBBARD. Mr. Clarke, I didn't ask you which steps your agency took to comply with Gramm-Rudman-Hollings.

Staff reductions, travel? Where did you—

Mr. CLARKE. All of those, Mr. Chairman. We believe we will be able to achieve 60 percent of the 1986 Gramm-Rudman-Hollings mandated reductions with non-staff-related cuts. We did, however, have to impose a hiring freeze, which has been in effect since early this year, and which we anticipate will result in 275 fewer field examiners by the end of our fiscal year.

Chairman HUBBARD. And what problems has this caused?

Mr. CLARKE. Approximately 700 community banks that would have otherwise had some onsite supervision from our examiners this year will not receive that attention. Such a decline in frequency of examination simply means that banks may go for longer periods of time with problems undetected.

Chairman HUBBARD. Mr. Clarke, how long does it take to train examiners?

Mr. CLARKE. As a general rule, it takes 5 years of training, both formal training and on-the-job training, before an examiner is commissioned as a national bank examiner.

Chairman HUBBARD. On page 10 of your testimony, you have listed three provisions of your program adopted to reduce fiscal year 1986 expenditures. The first two are exact and easy to understand. The third one simply says maintain minimal investment in programs that provide future cost savings or efficiencies in resource usage.

Could you be a little more specific?

Mr. CLARKE. Those were the criteria that we employed in cutting our budget to try to do the least damage to our system. Included under the third criterion would be such things as maintaining physical facilities for off-site monitoring. We have made a very extensive investment in data processing equipment, and we have had to cut back and defer expenditures that had been planned for acquiring new facilities and for refurbishing old facilities and simply make do with what we have.

Chairman HUBBARD. I notice that Congressman Steve Bartlett has had a chance to come back to the subcommittee hearing, and he has not had a chance to ask questions earlier.

Congressman Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman, and I do apologize for having left for a few minutes, and I very much appreciate the testimony of the witnesses and have read their testimony, and if I ask a question that has been previously covered, well, either try to give the same answer or maybe elaborate on your previous answer.

So I apologize if there is any redundancy in my questions.

My first question is fundamental and it goes to what you would recommend to us, to Congress to act upon this summer with regard to this issue of personnel issues within your agencies.

That is to say, do you believe that legislation like the Carper-Lundine legislation is sufficiently important to justify attaching it to the other legislation that is before us; specifically, the Garn-St Germain expansion legislation that was sent here by the regulators and the FSLIC recapitalization?

It seems to me, in prefacing the question, that that may be the only vehicle available. There is no other opportunity that I know of to pass legislation such as this to exempt your agencies from Gramm-Rudman.

So do you believe it is sufficiently important to attach it to that legislation?

Mr. SEIDMAN. I would certainly think that it is important at least to attach parts of that legislation. Some parts of it could wait, but I think the parts dealing with the exemption from the Anti-Deficiency Act and the parts dealing with the pay provisions are very important and should be attached at a minimum.

Mr. BARTLETT. Mr. Gray.

Chairman GRAY. Yes, I do. I think it is an excellent vehicle. Quite clearly, I believe on the Banking Committee that there is rather overwhelming support for that bill.

Again, my only difficulty with that bill is that we have now moved our examiners out to the Federal home loan bank districts, and this is working extremely well. I believe that the flexibility that currently exists ought to be maintained and that there should be no effort on the part of the bill to establish what examiner salaries ought to apply across the board to all agencies, I think even the recommending language of the bill that there should be an entity to recommend what they ought to be for our purposes—and I believe the Federal Reserve also testified this way—goes too far, given the flexibility that we already have to make those kinds of decisions.

Mr. BARTLETT. Chairman Gray, let me ask you specifically—and this is a followup question—

Mr. GRAY. Right.

Mr. BARTLETT [continuing.] In addition to mine but also to follow up to what Mr. Parris had asked earlier. Could you specify which parts of the Carper-Lundine bill, as drafted, limit your flexibility?

Mr. GRAY. I would say the part that recommends the kinds of salaries that ought to be applied across the board, and it is only recommending. I think that what is a recommendation in the beginning becomes more de facto in the end, and it seems to me that

that does take away our flexibility even if it is only a recommendation.

Mr. BARTLETT. OK, so——

Mr. GRAY. So, that is the only thing.

Mr. BARTLETT. That is the only thing?

Mr. GRAY. That is the only thing, absolutely the only thing.

Mr. BARTLETT. So in answer to Mr. Parris' question and in answer to mine, when you appear uneasy about something taking away your flexibility, that is the only item that you are referring to——

Mr. GRAY. That is the only thing.

Chairman HUBBARD. Is recommendations on salaries?

Mr. GRAY. Yes, right. Other than that——

Mr. BARTLETT. There's no other hidden sort of inflexible nature about this?

Mr. GRAY. Right.

Mr. BARTLETT. Mr. Comptroller.

Mr. CLARKE. I feel very strongly about the issues addressed in that legislation, particularly the Gramm-Rudman-Hollings and apportionment relief, which we have talked about in great detail this morning, and the issue of compensation. I think these are fundamental public policy issues that need to be addressed at the earliest possible time. If it is your judgment that the best vehicle to attach the Carper-Lundine bill to is the legislation to which you referred, then I would be all for including it.

Mr. BARTLETT. The second question would go to any—have you or your agencies, would you be prepared to provide us with some specific recommendations on any legislative changes that should be made to improve the quality of your personnel, as I read your testimony and the answers to questions, the three of you have testified in different ways, that because of pay caps and other things, that the quality of your personnel could stand some beefing up.

My question is, first of all, how would you assess the incoming quality of your examiners force, and second, what is it that you need us to do to improve it, to help you improve that quality?

Mr. SEIDMAN. I can say in our case that one of the great handicaps we have is the hiring procedures which are required by OPM, which, in effect, do not allow us to hire from a college campus without requiring each applicant to fill out a huge number of forms and fill out a test and have it judged. So we can't go on the campus like other employers and hire somebody. If we find somebody, we would be fortunate if 4 to 5 months later, we could offer them a job. As a result of that, we lose out time and time again on people that we would like to hire, because of the required Civil Service rules.

So exemption from that, which we would get, as I understand it, under Carper-Lundine, would be a major step forward in helping us to build a good examination force.

Mr. BARTLETT. All right.

Mr. GRAY. Yes; that's the same case for us. Of course, we are under OPM also. While that doesn't affect any of the examiners or supervisors in the Federal home loan bank districts, it does affect everybody at the Bank Board. And let me give you a real-life example of that, Congressman.

Before we transferred our examiners, the entry-level salary was \$14,000 a year for an examiner. And as a result, because of these pay structures imposed on us by the requirements of the Office of Personnel Management, the average salary for an examiner in our system was \$25,000 a year. Those are some darn good reasons to move the examination apparatus out from under these requirements to the Federal home loan banks. The moment we did that, we increased the entry-level salaries that we could pay our examiners to \$21,000. And now we have the ability to attract good examiners and to pay what is needed to attract them and to keep them. These increased salaries make all that training and that investment in training that we provide, cost-effective rather than to lose them as soon as they work for a year or so and then leave.

We had tremendous turnover rates. I remember in the Dallas district, the turnover rate for our examiners was 28 percent a year.

Mr. BARTLETT. And you are suggesting that with your flexibility, putting those examiners under the aegis of the district bank, well, then you have sufficient flexibility to attract quality personnel?

Mr. GRAY. As long as we can maintain that flexibility, you bet.

Mr. BARTLETT. And your additional—the only additional problem you have is in streamlining the hiring procedures, or is that an additional problem?

Mr. GRAY. Well, with respect to examination and supervision, anything in the Federal home loan bank districts, that's fine. We don't need to touch that. We have all the flexibility we need. We're doing just fine. What we do have the problem with is what is left at the bank board. What is left at the bank board all comes under these kinds of things that he is talking about.

Mr. BARTLETT. OK. Mr. Clarke.

Mr. CLARKE. I believe one of the questions was to assess the quality.

Mr. BARTLETT. Yes.

Mr. CLARKE. Overall, the quality of our examination staff is very good. The problem we have is not quality, but keeping the quality. As I testified earlier, most of our examiners are home grown. There's really not a place that you can go in the market to hire someone who is trained as a bank examiner, unless you raid the FDIC or the Federal home loan bank board, and we sort of have a mutual pact that we won't do that any more than absolutely necessary. [Laughter.]

Mr. BARTLETT. Unless it is a real good acquisition. [Laughter.]

Mr. CLARKE. Unless it's a real good acquisition; that's right.

It takes 5 years on the average to train an examiner to become a commissioned national bank examiner. When we lose such an examiner, we lose the 5-year investment in getting him or her to the point of being very effective in dealing with an institution. Then we have to start the 5-year cycle all over again. Our problem is really getting ourselves into a posture where we don't lose as many of these trained, qualified examiners to private industry, which is where they're going, in large part. That can be done only when our compensation levels have some more flexibility.

Mr. BARTLETT. How far below comparable private sector personnel are your compensation levels, in your opinion?

Mr. CLARKE. It's difficult to generalize but, on the average, a commissioned national bank examiner earns somewhere in the \$32,000 to \$35,000 range. Most of the banks who are hiring these people away are paying in excess of \$50,000. Now that's just for starters.

The problem is, as that 5-year examiner weighs a career with our agency versus a career in private industry, the compensation gap gets wider and wider and wider over time. And a decision has to be made at some point in that person's career as to whether he or she would be better off going to private industry and investing time there rather than staying with the agency. This is a problem that is not peculiar to our agency. It's common throughout Government. Because we fund ourselves differently than the rest of Government and because our employees have special skills, however, it seems to me that there is a justification for allowing us greater flexibility in this area.

Mr. GRAY. Congressman, if I could just add——

Mr. BARTLETT. Yes.

Mr. GRAY. Certainly in the national bank area but in the thrift area, we are dealing and seeing the most sophisticated financial transactions in the history of finance. We have new examiners come in, and we try to train them. It does take time. It takes time to train supervisors to follow up on examination. And as a result, the need to pay adequate remuneration for these people, to keep them, with all of the skills that they develop over time, in dealing with these financial transactions, as sophisticated as they are, it seems to me, require that we accept the reality of this, as we have in the Federal Home Loan Bank System, because we have had the ability to do that, to pay what is necessary to make that training investment, that investment in human resources pay off in the end, and keep them.

Otherwise, trying to stay abreast and stay on top of these sophisticated financial transactions and provide effective examination and supervision are much more difficult.

Mr. BARTLETT. Mr. Clarke, does this legislation, as you read it, the Carper-Lundine bill, does it provide you with an opportunity to upgrade the quality of your personnel, or to put it another way, to be able to retain high-quality personnel, if you have what you testified is a 60-percent gap between the private sector and your comparable examiner? This legislation, as I read it, the summary of it, would establish an exam council to give you a recommendation on your setting salaries, but do you have the ability to set salaries now that are competitive with the private section, and if you do, why aren't you doing it?

Mr. CLARKE. We do not have that ability since we are subject to the overall Government pay cap. We have flexibility within our compensation system at the lower levels, and we are exercising that. In fact, that's the only reason that we are able to pay the 5-year examiner at the \$32,000 to \$35,000 level. Because we are subject to the cap, however, there is a bunching of more senior people, and they get to be bunched pretty early in their careers. We do not have the flexibility at the present time to offer competitive salaries across the board. The bill would, as I understand it, give us that flexibility.

Mr. BARTLETT. So this legislation would help you resolve our quality of personnel difficulty?

Mr. CLARKE. It would. I will be candid with you and tell you, however, that it's not just dollars that will do the job. We need the flexibility to have a compensation program that works, but then it's up to us also to provide the kind of working environment and the kind of training that makes people want to stay.

Mr. BARTLETT. Thank you, Mr. Chairman, for the additional time.

Chairman HUBBARD. Thank you, Congressman Bartlett.
Congressman Kanjorski.

Mr. KANJORSKI. Thank you very much, Mr. Chairman. I have just one or two questions.

I really direct the question to all three gentlemen.

In making the assumption that the Supreme Court, within a short period of time, were to rule unconstitutional, the automatic sequestration under Gramm-Rudman, as I understand the fallback position, is that a special committee would be formed and would have 5 days to perform the function that the GAO would normally perform under Gramm-Rudman, and then that resolution would go to the Congress, and the Congress would have 5 days to act on the resolution. And under the law, we could not amend it to take your agencies out.

So assuming we don't get any relief under Carper and Lundine, and we now go to the floor with an up or down vote on the whole package, is the threat to your funds and your agencies of such a severe nature that you would recommend to the Congress that we vote down that resolution?

Mr. GRAY. Somebody else can take it first this time. [Laughter.]

Mr. CLARKE. I am not sure that it is appropriate for us to be providing you with recommendations on the wisdom of the overall Gramm-Rudman approach.

Mr. KANJORSKI. Wait. You are recommending that we pass Carper-Lundine. If you can recommend to the Congress that we pass something, can't you recommend to the Congress whether or not we reject something?

Mr. CLARKE. Carper-Lundine relates to the specific areas within the Government that we deal with, and I feel competent to make that recommendation to you. But it does seem inappropriate for me to make a recommendation about the overall concept of deficit reduction embodied in Gramm-Rudman, which is really what your question addresses.

Mr. KANJORSKI. No; I am asking you—you tell us how severe this problem is to the banking institutions that you regulate. Now is it so severe that when we have the up and down vote, we should take the thing down, so that we don't go down draining your agency. I am not trying to put you on the spot. I am just really trying to get to just how severe is the problem.

If you feel it is not severe, that it should go down, then I think I could reasonably assume that you can work within the confines of Gramm-Rudman. And if you can, then the remedial legislation necessary, perhaps, isn't as necessary as we are led to believe by all of your testimony today. I think that's a—

Mr. GRAY. Congressman, that's a hypothetical example, because that is not the only avenue available to the Congress. The Congress can act in many ways, and the Congress can make adjustments to Gramm-Rudman.

Mr. KANJORSKI. I agree. I prefaced my remarks, assuming that Carper-Lundine does not get passed, does not become law, that we don't have the capacity to get a vehicle to give you the relief you desire from Gramm-Rudman, and supposing the Supreme Court rules against Gramm-Rudman within the next few weeks, and we have 5 days to have a special committee, and the Congress has 5 days to act, and the Congress cannot put an amendment to exempt you out. So we are absolutely faced with the proposition, perhaps 17 days from now, that either you go on under Gramm-Rudman or we vote that resolution down.

That is the proposition.

Mr. GRAY. Well, you are our board of directors in the sky. And you are elected to make those kinds of decisions.

Mr. KANJORSKI. Well, suppose we make the decision to pass it, that you haven't convinced us that it's so severe. Let's play the role of the President now. Do you recommend that he veto, or do you recommend that he sign? Now he certainly, as Chief Executive, he has the right to call on you gentlemen for a recommendation, doesn't he?

Mr. GRAY. It seems to me that—just speaking for myself, which is a bit beyond the purview of a savings and loan regulator—I could offer a suggestion to the Congress and the President. You all have a great deal of resources to make those kinds of decision, and they are appropriately your decisions.

And the other thing, these are all hypotheticals, and I feel very uncomfortable answering hypothetical questions.

Mr. KANJORSKI. OK. The simplicity of it, though, if there is an up-and-down vote, you are unwilling to give a recommendation as to how to vote on it regardless of how severely it affects your individual agency; is that correct?

Mr. GRAY. Yes; I think it would be inappropriate for me to make that kind of recommendation as a savings and loan regulator.

Mr. KANJORSKI. Mr. Seidman, what was your response to my question?

Mr. SEIDMAN. Well, as I understand the purpose of Gramm-Rudman, it is simply to say the Congress needs to—agrees to meet a certain budget level, and Gramm-Rudman is not supposed—that is across-the-board cuts were never intended to be the effect of that legislation, but simply to put the Congress in a position where they would pass a budget. So I would say, vote for Gramm-Rudman and then come back and pass a budget, whether it has more taxes or more cuts, but I—

Mr. KANJORSKI. Mr. Seidman, we can assume at this time, the 13 appropriations bills, not one has passed the House of Representatives or the Senate, neither has the budget resolution of the House or Senate or the President's passed. I think only 12 Members of the Congress supported the President's budget, and I don't see any support in both Houses for the other two alternatives.

Mr. SEIDMAN. But miracles happen. Look at the tax bill.

Mr. KANJORSKI. OK. If a miracle doesn't happen—Mr. Seidman, and since I am up on the Hill only 18 months, I have become more of a pessimist as to the happening of miracles. [Laughter.] And the Supreme Court 1 week from now rolls down the automatic sequestration, and we have the 5 days for the special committee and the 5 days for the resolution to get to the floor which we can't amend. So it's an up and down vote. Is it so severe, to your institutions, that you would recommend I vote against it, or is it not that severe that you could take the cuts under Gramm-Rudman next year?

Mr. SEIDMAN. I guess I can't answer the question, in terms of whether it's that severe on our agency. As I said, I guess if I were a Congressman, I would vote for it, and then try to get a budget which is not across-the-board cuts, which is the worst of all government. So I guess that would be the best answer that I could give you, if I had the responsibility.

Mr. KANJORSKI. Thank you very much. [Laughter.]

Thank you, Mr. Chairman.

Chairman HUBBARD. It is time we bring this to a conclusion.

Please let me ask one more question of each of you, and then you can answer briefly.

On page 12, Mr. Clarke, of your testimony, you indicate "The administration favors Congress reconsidering the applicability of Gramm-Rudman-Hollings to the banks regulators for 1987 and beyond."

No. 1, are you saying that the administration would be in favor of exempting the regulators for 1987 and beyond?

Mr. CLARKE. That is my understanding; yes, sir.

Chairman HUBBARD. You would be in favor of the administration exempting the regulators for 1987 and beyond? You have highlighted the problems of Gramm-Rudman-Hollings, it is causing for your office in fiscal year 1986. What about 1987? Do you predict it will be worse?

Mr. CLARKE. Of course, the cuts that would have to be taken in 1987 depend, to some extent, on the extent of the budget deficit and could range from 0 to as high as 25 percent, as I am advised. Anything much above 0 is going to have a severe impact on us because, as I have explained, we're currently operating at a very thin level.

Chairman HUBBARD. Thank you.

And Mr. Gray, one last question.

On page 4 of your testimony, you mention the need for FSLIC to react quickly to imminent thrift failures.

How does apportionment affect those efforts?

Mr. GRAY. Well, I guess my vote would be that we need as much flexibility as we can have, and I think there are instances, potential instances, certainly, where that flexibility is reduced by virtue of the apportionment process.

Chairman HUBBARD. Mr. Seidman, do you believe that decreased supervision caused by the cuts imposed by Gramm-Rudman-Hollings could eventually open the floodgates of illegal activity by banks? For example, more money laundering and bank fraud than we have seen in the past?

Mr. SEIDMAN. I think it's clear that supervision is necessary to control these kinds of activities and, therefore, if we don't have supervision, we will see more of those activities.

Chairman HUBBARD. Thanks to each of you, Mr. Seidman, Mr. Gray, Mr. Clarke. We appreciate you and your agencies, the work that you do. Your being with us shows us for sure today what problems you have and how they relate to Gramm-Rudman-Hollings. The Congress has its problems too, and Mr. Kanjorski's been here only 18 months. I have been here 12 years, and I am more of a pessimist than even he is, as to our ability to do those things we should do, regardless of the fallout, politically.

Thank you again for being with us. And I do want to thank our subcommittee staff. Mary Martha Fortney, the staff director; Greg Carter, the counsel; Ed Carroll, minority counsel, Pam Satterwhite, our clerk; Kim Trimbball of the minority staff; and Joe Maggio, the reporter.

We now stand adjourned.

[Whereupon, at 12:30 p.m., the hearing was adjourned.]

[Letters of invitation to witnesses of this day's hearing follow:]

CARROLL HUBBARD, JR. KENTUCKY, CHAIRMAN

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U.S. HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SUBCOMMITTEE ON GENERAL OVERSIGHT
AND INVESTIGATIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM B-304 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515

June 5, 1986

STAN FARRIS VIRGINIA
GEORGE C. WOOLLEY NEW YORK
DAVID GREEN CALIFORNIA
STEVE BARTLETT TEXAS
ROD CHANDLER WASHINGTON
AL MICHAELSSON CALIFORNIA

Honorable D. William Seidman, Chairman
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW
Washington, DC 20429

Dear Mr. Chairman:

As you know, the Subcommittee on General Oversight and Investigations of the House Banking Committee is holding a hearing on the effects of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings) and the Anti-Deficiency Act (apportionment) on the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency and the National Credit Union Administration.

I am pleased that you will be testifying on this subject, as it relates to your respective agency, on Tuesday, June 17, at 10:00 a.m., in Room 2128 of the Rayburn House Office Building. Please direct your remarks on the impact Gramm-Rudman-Hollings and apportionment will have on your agency's abilities to supervise, examine and generally oversee the operations of your member institutions. The members of the Subcommittee and I look forward to receiving your testimony on Tuesday, June 17.

We request 100 copies of your printed testimony by close of business Friday, June 13, at Room B-304 Rayburn Building. If you have any questions, please contact our staff director, Mary Martha Fortney, or our counsel, Greg Carter, at 225-2828.

With best wishes for you, I am

Sincerely yours,

*Carroll Hubbard*CARROLL HUBBARD
Chairman

CH/umf

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SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM B-304 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515

June 5, 1986

COPY

Honorable Edwin J. Gray
Chairman
Federal Home Loan Bank Board
1700 G Street, NW
Washington, DC 20552

Dear Ed:

As you know, the Subcommittee on General Oversight and Investigations of the House Banking Committee is holding a hearing on the effects of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings) and the Anti-Deficiency Act (apportionment) on the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency and the National Credit Union Administration.

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With best wishes for you, I am

Sincerely yours,

Carroll Hubbard

CARROLL HUBBARD
Chairman

CH/nmf

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SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS

(OF THE)

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM B-304 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515

June 5, 1986

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COPY

Honorable Robert L. Clarke
Comptroller of the Currency
490 L'Enfant Plaza East, SW
Washington, DC 20219

Dear Mr. Comptroller:

As you know, the Subcommittee on General Oversight and Investigations of the House Banking Committee is holding a hearing on the effects of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings) and the Anti-Deficiency Act (apportionment) on the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency and the National Credit Union Administration.

I am pleased that you will be testifying on this subject, as it relates to your respective agency, on Tuesday, June 17, at 10:00 a.m., in Room 2128 of the Rayburn House Office Building. Please direct your remarks on the impact Gramm-Rudman-Hollings and apportionment will have on your agency's abilities to supervise, examine and generally oversee the operations of your member institutions. The members of the Subcommittee and I look forward to receiving your testimony on Tuesday, June 17.

We request 100 copies of your printed testimony by close of business Friday, June 13, at Room B-304 Rayburn Building. If you have any questions, please contact our staff director, Mary Martha Fortney, or our counsel, Greg Carter, at 225-2828.

With best wishes for you, I am

Sincerely yours

Carroll Hubbard

CARROLL HUBBARD
Chairman

CH/mm

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U.S. HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS

(OF THE)

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ROOM B-304 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515

June 5, 1986

COPY

Honorable Roger W. Jepsen, Chairman
National Credit Union Administration
1776 G Street, NW
Washington, DC 20456

Dear Senator Jepsen:

As you know, the Subcommittee on General Oversight and Investigations of the House Banking Committee is holding a hearing on the effects of the Deficit Reduction Act of 1985 (Gramm-Rudman-Hollings) and the Anti-Deficiency Act (apportionment) on the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Office of the Comptroller of the Currency and the National Credit Union Administration.

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With best wishes for you, I am

Sincerely yours,

Carroll Hubbard

CARROLL HUBBARD
Chairman

CH/mm